A Dispute over Bona Fide Disputes in Involuntary Bankruptcy Proceedings

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INTRODUCTION

The world of federal bankruptcy law is divided into two realms: voluntary bankruptcy proceedings and involuntary bankruptcy proceedings. Section 303 of the Bankruptcy Code governs involuntary bankruptcy proceedings. Under § 303(b)(1), a set of creditors can force a debtor into involuntary bankruptcy provided that, among other things, each creditor possesses a claim against the debtor that is not "the subject of a bona fide dispute."[1] Despite the importance of this seemingly simple requirement, the Bankruptcy Code does not define the term "bona fide dispute."

Parties commonly use involuntary bankruptcy to collect money judgments issued in prior proceedings by nonbankruptcy state courts. In the typical case, a set of plaintiffs brings suit against a defendant in state court and ultimately secures a money judgment. The judgment constitutes a claim against a debtor within the meaning of the Bankruptcy Code. Assuming that the defendant does not dispute the money judgment, the victorious plaintiffs (now creditors) can use their claims against the defendant (now debtor) to file an involuntary bankruptcy petition in federal bankruptcy court. However, when the creditors' claims against the debtor include an unstayed state court judgment,[2] a dilemma arises when the debtor appeals the underlying state court judgment before the creditors file their involuntary bankruptcy petition. On the one hand, the court could find, as

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1 11 USC § 303(b)(1).

2 A stay is "[a]n order to suspend all or part of a judicial proceeding or a judgment resulting from that proceeding." *Black's Law Dictionary* 1548 (West 9th ed 2009). An unstayed judgment is simply a judgment that is not subject to such an order.

debtors in these types of cases often advocate, that the appeal of the state court judgment creates a bona fide dispute within the meaning of § 303, thereby rendering the creditors ineligible to proceed with their involuntary bankruptcy petition. On the other hand, the court could find, as creditors often advocate, that the appeal can *never* create a bona fide dispute over an otherwise enforceable judgment.

The dilemma appears intractable for at least two reasons. First, although the legislative history of § 303 expresses a general purpose of the bona fide dispute requirement, that purpose, in conjunction with a relatively sparse legislative record, provides little interpretive guidance.[3] Second, the question implicates significant federalism concerns. It is unclear whether federal bankruptcy courts should apply state or federal law to determine whether an appeal creates a bona fide dispute.[4] While federal bankruptcy law creates the bona fide dispute requirement, federal courts—including federal bankruptcy courts—generally must look to state law to determine what effect to give state court judgments.[5] Thus, a federal bankruptcy court's determination that the appeal of a state court judgment can create a bona fide dispute under federal law potentially fails to respect a state court's determination of state law.

Because of these difficulties, courts have struggled to determine whether the appeal of an unstayed state court judgment can create a bona fide dispute within the meaning of § 303. Federal bankruptcy courts have offered competing answers for nearly three decades. More recently, a circuit split has developed. The Fourth Circuit adheres to the view that the appeal of an unstayed state court judgment *can*, under appropriate circumstances, create a bona fide dispute within the meaning of § 303.[6] The Ninth Circuit, to the contrary, follows the per se rule that the appeal of an unstayed state court judgment can *never* create a bona fide dispute within the meaning of § 303.[7] The resulting circuit split has created significant confusion among bankruptcy courts and practitioners alike.

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3 See Part I.C.

4 See notes 127–30 and accompanying text.

5 See 28 USC § 1738. See also Part III.B.

6 See Part II.B.

7 See Part II.C.

This Comment seeks to resolve this issue. Specifically, it aims to show that existing judicial approaches fashion uniform federal rules that go against well-established Supreme Court precedent favoring the adoption of state law as the federal rule of decision. Relying on these observations, this Comment argues that federal bankruptcy courts should adopt state issue preclusion law as the federal rule of decision to determine whether an appeal creates a bona fide dispute. If, under the applicable state issue preclusion law, an appeal does not affect the finality of judgments for the purpose of issue preclusion, then the appeal cannot create a bona fide dispute. But if an appeal renders a judgment nonfinal for the purpose of issue preclusion, then the appeal can create a bona fide dispute. By looking to state law to determine whether an appeal can create a bona fide dispute, the proposed approach avoids the federalism concerns noted above, renders the interpretation of § 303 consistent with other bankruptcy and nonbankruptcy legal doctrines, and potentially reconciles conflicting judicial interpretations.

This Comment proceeds in three parts. Part I provides an overview of involuntary bankruptcy, the legislative development of § 303, and judicial interpretations of the bona fide dispute requirement. Part II describes the circuit split concerning whether the appeal of an unstayed state court judgment can create a bona fide dispute within the meaning of § 303. Finally, Part III proposes and defends this Comment's issue preclusion approach.

I. THE HISTORY AND PURPOSE OF INVOLUNTARY BANKRUPTCY AND THE BONA FIDE DISPUTE REQUIREMENT

This Part provides an overview of involuntary bankruptcy. It first discusses the mechanics and general purpose of involuntary bankruptcy in its current form. It then tracks the legislative development of § 303 from its enactment in 1978 to its amendments in 1984 and 2005. Finally, it describes predominant judicial interpretations of § 303 and the bona fide dispute requirement.

A. The Mechanics of Modern Involuntary Bankruptcy

Section 303(b)(1) sets forth the requirements for commencing an involuntary bankruptcy petition. It provides:

> 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 [ ] by three or more entities, each of which is either 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.[8]

Section 303(h)(1) likewise provides that a bankruptcy court may grant relief to creditors in an involuntary bankruptcy proceeding "only if [ ] the debtor is generally not paying such debtor's debts as such debts become due unless such debts are the subject of a bona fide dispute as to liability or amount."[9] Section 303(b)(2) permits a single creditor to commence an involuntary bankruptcy proceeding against a debtor provided that the debtor has fewer than twelve creditors and the petitioning creditor possesses claims totaling at least $15,325.[10] The Bankruptcy Code defines a "claim" as a "right to payment, whether or not such right is reduced to judgment."[11] The Bankruptcy Code does not define "bona fide dispute" for purposes of involuntary bankruptcy or otherwise.

Involuntary bankruptcy is first and foremost a "creditors' remedy."[12] As one bankruptcy court explained, "The purpose of an involuntary [bankruptcy] procedure is to provide a method for creditors to protect their rights against debtors who are not meeting their debts."[13] Federal bankruptcy is designed to allow creditors to act collectively to pursue payments from a debtor and deter creditors from individually pursuing payment outside of bankruptcy.[14] By encouraging group action, bankruptcy law "discourage[s] [creditors] from racing to the courthouse to

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8 11 USC § 303(b)(1).

9 11 USC § 303(h)(1).

10 11 USC § 303(b)(2).

11 11 USC § 101(5)(A).

12 Lawrence Ponoroff, *The Limits of Good Faith Analyses: Unraveling and Redefining Bad Faith in Involuntary Bankruptcy Proceedings*, 71 Neb L Rev 209, 300 (1992).

13 *In re All Media Properties, Inc*, 5 Bankr 126, 137 (Bankr SD Tex 1980). See also *In re Apache Trading Group, Inc*, 229 Bankr 891, 894 (Bankr SD Fla 1999) ("Legitimate reasons for filing an involuntary bankruptcy petition include the invocation of the protection of the Bankruptcy Court to protect the petitioning creditors and the other creditors, and the investigation, accounting for, and protection of the debtor's assets.").

14 For influential discussions of collective action problems in the bankruptcy context, see Thomas H. Jackson, *Bankruptcy, Non-bankruptcy Entitlements, and the Creditors' Bargain*, 91 Yale L J 857, 859–71 (1982) (describing how bankruptcy laws allow creditors to act collectively to avoid "race[s] to use individualistic remedies"); Douglas G. Baird and Thomas H. Jackson, *Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U Chi L Rev 97, 105–09 (1984) (explaining that the central purpose of federal bankruptcy law is to create "a collective proceeding" that requires creditors "to act collectively").

dismember the debtor."[15] Consistent with the overarching purposes of bankruptcy, courts and commentators generally agree that the purpose of involuntary bankruptcy is to coordinate action among numerous creditors and to discourage creditors from individually pursuing nonbankruptcy enforcement procedures to "dismember" the debtor.[16] Involuntary bankruptcy "ensure[s] an orderly ranking of creditors' claims, one of the central purposes of the Bankruptcy Code, since it will enable [the creditor] to participate ratably with other creditors in the liquidation of [the debtor's] assets."[17]

B. The Bankruptcy Reform Act of 1978 and Pre-amendment Interpretations of § 303

The Bankruptcy Reform Act of 1978[18] created modern involuntary bankruptcy proceedings. The Act's requirements for involuntary bankruptcy are substantially similar to present-day requirements. The 1978 version of § 303(b)(1) allowed three or more creditors to file an involuntary bankruptcy petition against a debtor provided that the claim in question was "not contingent as to liability."[19] The 1978 version of § 303(h)(1) likewise provided that "the court shall order relief against the debtor in an involuntary case . . . [if] the debtor is generally not paying such debtor's debts as such debts become due."[20] Under the 1978 law, neither § 303(b)(1) nor § 303(h)(1) included the bona fide dispute requirement.

Federal bankruptcy courts offered competing interpretations of the requirements for involuntary bankruptcy under the

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15 *Coral Petroleum, Inc v Banque Paribas-London*, 797 F2d 1351, 1355 (5th Cir 1986), quoting *Bankruptcy Law Revision*, HR Rep No 95-595, 95th Cong, 1st Sess 177 (1977), reprinted in 1978 USCCAN 5963, 6138.

16 See, for example, *In re Manhattan Industries, Inc*, 224 Bankr 195, 200 (Bankr MD Fla 1997) ("The central policy behind involuntary petitions was to protect the threatened depletion of assets or to prevent the unequal treatment of similarly situat[ed] creditors."); *In re Arker*, 6 Bankr 632, 636 (Bankr EDNY 1980) ("[T]he purpose of an involuntary proceeding [ ] is to secure an equitable distribution of the assets of the alleged debtor among all his creditors."). See also William J. Burnett, *Prepetition Waivers of the Automatic Stay: Automatic Enforcement Equals Automatic Trouble*, 5 J Bankr L & Prac 257, 264 (1996) ("[S]olving the collective action problem and allowing debtors to reorganize are the main objectives of the Bankruptcy Code.").

17 *In re H.I.J.R. Properties Denver*, 115 Bankr 275, 279 (D Colo 1990) (quotation marks and citation omitted).

18 Pub L No 95-598, 92 Stat 2549, codified as amended in various sections of Title 11.

19 Bankruptcy Reform Act of 1978 § 303(b)(1), 92 Stat at 2559.

20 Bankruptcy Reform Act of 1978 § 303(h)(1), 92 Stat at 2560.

original § 303.[21] The major disagreement was whether creditors could initiate involuntary bankruptcy proceedings when the debtor disputed the creditors' claims.[22] Many courts allowed creditors to file involuntary bankruptcy petitions against a debtor even if the debtor disputed the claim.[23] Other courts, however, suggested that creditors could not initiate involuntary bankruptcy proceedings against a debtor when the debtor genuinely disputed the claim.[24] Some courts specified that creditors were disqualified from initiating involuntary bankruptcy proceedings only when the debtor disputed the claims "in good faith."[25] These conflicting judicial interpretations rendered the requirements for filing an involuntary bankruptcy petition inconsistent across jurisdictions.

C. The Bankruptcy Amendments and Federal Judgeship Act of 1984

Congress clarified the requirements for filing an involuntary bankruptcy petition in the Bankruptcy Amendments and Federal

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[21] For detailed summaries of the pre-amendment case law, see Lawrence Ponoroff, *Involuntary Bankruptcy and the Bona Fides of a Bona Fide Dispute*, 65 Ind L J 315, 324–29 (1990); Eric J. Taube, *Involuntary Bankruptcy: Who May Be a Petitioning Creditor?*, 21 Houston L Rev 339, 345–50 (1984).

[22] See David S. Kennedy, James E. Bailey III, and R. Spencer Clift III, *The Involuntary Bankruptcy Process: A Study of the Relevant Statutory and Procedural Provisions and Related Matters*, 31 U Memphis L Rev 1, 12 (2000) ("Prior to the 1984 amendments . . . [s]ome courts held that holders of disputed claims were permitted to be qualified, petitioning creditors. Other courts held that holders of disputed claims could not be qualified, petitioning creditors.").

[23] See, for example, *In the Matter of Covey*, 650 F2d 877, 878 (7th Cir 1981) ("[W]e hold that creditors holding disputed claims are not, because of those disputes, disqualified from petitioning for involuntary bankruptcy."); *All Media Properties, Inc*, 5 Bankr at 133 ("[J]ust because a claim is [ ] disputed . . . does not mean it is contingent."). See also *In re Tarletz*, 27 Bankr 787, 789–90 (Bankr D Colo 1983); *In re Dill*, 30 Bankr 546, 549 (BAP 9th Cir 1983); *In re Marshall*, 37 Bankr 108, 110 (Bankr SD Fla 1984); *In re Longhorn 1979-II Drilling Program*, 32 Bankr 923, 926 (Bankr WD Okla 1983).

[24] See, for example, *In re B.D. International Discount Corp*, 701 F2d 1071, 1076 (2d Cir 1983) (expressing doubt that "Congress intended that a debtor should be found to be generally not paying its debts as they become due . . . when the claim is subject to serious dispute"); *In re First Energy Leasing Corp*, 38 Bankr 577, 582 (Bankr EDNY 1984). See also *In re Reid*, 773 F2d 945, 947 (7th Cir 1985) ("Several courts [ ] expressed doubt that Congress really intended for a creditor to be able to bring a claim under section 303(b)(1) when that claim was subject to serious dispute.").

[25] *In re SBA Factors of Miami, Inc*, 13 Bankr 99, 100 (Bankr SD Fla 1981) ("The fact that [the creditors'] claims are disputed does not destroy petitioners' standing to file this involuntary proceeding. However, failure to pay several claims, disputed in good faith, does not prove that the debtor is generally not paying its debts as they become due.").

Judgeship Act of 1984[26] (BAFJA). Congress enacted BAFJA in response to the Supreme Court's 1982 decision in *Northern Pipeline Construction Co v Marathon Pipe Line Co.*[27] The decision invalidated the Bankruptcy Reform Act of 1978 in its entirety on the ground that it unconstitutionally delegated jurisdiction over certain civil proceedings to non–Article III bankruptcy judges.[28] BAFJA purported "[t]o amend title 28 of the United States Code regarding jurisdiction of bankruptcy proceedings, to establish new Federal judicial positions, [and] to amend title 11 of the United States Code."[29]

BAFJA notably incorporated the bona fide dispute requirement into § 303 for the first time.[30] Although BAFJA created the requirement, the Act did not define the term "bona fide dispute." Similarly, the amendment's limited legislative record does not provide much guidance as to the term's meaning. The record does, however, point to the amendment's general purpose. While introducing the amendment on the Senate floor, Senator Max Baucus of Montana briefly explained the purpose of the bona fide dispute requirement:

> The problem can be explained simply. Some courts have interpreted section 303's language . . . as allowing the filing of involuntary petitions and the granting of involuntary relief even when the debtor's reason for not paying is a legitimate and good-faith dispute over his or her liability. This interpretation allows creditors to use the Bankruptcy Code as a club against debtors who have bona fide questions about their liability, but who would rather pay up than suffer the stigma of involuntary bankruptcy proceedings.

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26 Pub L No 98-353, 98 Stat 333, codified as amended at 11 USC § 101 et seq.

27 458 US 50 (1982) (Brennan) (plurality). See also Sheldon A. Wilensky, Comment, *The Bankruptcy Amendments and Federal Judgeship Act of 1984: An Unconstitutional Vesting of Subject Matter Jurisdiction*, 23 San Diego L Rev 939, 939 (1986).

28 See *Northern Pipeline*, 458 US at 87 (Brennan) (plurality). See also Jeffrey T. Ferriell, *Constitutionality of the Bankruptcy Amendments and Federal Judgeship Act of 1984*, 63 Am Bankr L J 109, 109 n 2 (1989) ("In *Northern Pipeline* the Court invalidated former 28 U.S.C. § 1471(c) (1982), which permitted bankruptcy judges, who lacked the salary and tenure protections required to be given to article III judges, to exercise jurisdiction over, inter alia, civil proceedings related to a bankruptcy case."); Richard F. Dole Jr, *The Availability and Utility of Chapter 13 of the Bankruptcy Code to Farmers under the 1984 Bankruptcy Amendments*, 16 Tex Tech L Rev 433, 434 (1985).

29 BAFJA, 98 Stat at 333.

30 See Rachel Green, Note, *Treating Section 303(b) of the Bankruptcy Code as Subject-Matter Jurisdictional: Sound Approach or Involuntary Reflex?*, 75 Brooklyn L Rev 865, 878 (2010).

> My amendment would correct this problem. Under my amendment, the original filing of an involuntary petition could not be based on debts that are the subject of a good-faith dispute between the debtor and his or her creditors. In the same vein, the granting of an order of relief could not be premised solely on the failure of a debtor to pay debts that were legitimately contested as to liability or amount.[31]

Baucus further contended that the proposed amendment would protect debtors' rights, prevent creditors from using bankruptcy law to coerce debtors, and "correct[ ] a judicial misinterpretation of existing law and congressional intent as to the proper basis for granting involuntary relief."[32]

Immediately following Baucus's statement, the Senate adopted the amendment.[33] Aside from the Senator's statement, neither the House nor the Senate extensively discussed the amendment's purpose or meaning. Congress passed BAFJA, and President Ronald Reagan signed it into law on July 10, 1984. In his signing statement, Reagan made no specific mention of the amendment to § 303 but did state, "The bill . . . remedies abuses by both debtors and creditors in consumer bankruptcy proceedings."[34] BAFJA's legislative history thus reflects that the primary purpose of the bona fide dispute requirement is to protect debtors from coercive creditors.

D. Post-amendment Judicial Interpretations of § 303

Given Congress's failure to define "bona fide dispute" for the purposes of involuntary bankruptcy proceedings, courts have struggled to give meaning to § 303.[35] In the years following BAFJA's enactment, courts proposed a number of standards for determining what constitutes a bona fide dispute under § 303, ultimately settling on an objective-basis standard.

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31 Bankruptcy Amendments of 1984, HR 5174, 98th Cong, 2d Sess (Mar 19, 1984), in 130 Cong Rec 17150, 17151 (June 19, 1984) (statement of Senator Baucus).

32 Id.

33 See id.

34 Ronald Reagan, *Statement on Signing H.R. 5174 into Law*, 20 Weekly Comp Pres Doc 1010, 1010 (July 10, 1984).

35 For summaries of the post-amendment case law, see Ponoroff, 65 Ind L J at 335–44 (cited in note 21); Kennedy, Bailey, and Clift, 31 U Memphis L Rev at 11–16 (cited in note 22); Green, Note, 75 Brooklyn L Rev at 875–83 (cited in note 30).

1. The *Johnston Hawks* good faith standard and the *Stroop* summary judgment standard.

In re Johnston Hawks, Ltd[36] and *In re Stroop*[37] constitute the earliest judicial attempts to interpret "bona fide dispute."[38] The bankruptcy court in *Johnston Hawks* established a good faith standard for determining whether a bona fide dispute exists. The court defined a bona fide dispute as "a conflict in which an assertion of a claim or right made in good faith and without fraud or deceit on one side is met by contrary claims or allegations made in good faith and without fraud or deceit on the other side."[39] The bankruptcy court in *Stroop* established a summary judgment standard for determining whether a bona fide dispute exists. Under this standard, a bona fide dispute exists if there is a genuine issue of material fact or law.[40] As the *Stroop* court explained, a claim is subject to a bona fide dispute "[i]f the defense of the alleged debtor to the claim of the petitioning creditor raises material issues of fact or law so that a summary judgment could not be rendered as a matter of law in favor of the creditor on a trial of the claim."[41]

Neither the *Johnston Hawks* good faith standard nor the *Stroop* summary judgment standard garnered many adherents. Courts largely rejected the good faith standard on the ground that it required an inappropriate analysis of the subjective intent of the parties.[42] Courts likewise rejected the *Stroop* summary judgment standard because it would require federal bankruptcy judges to inappropriately resolve questions of law when no genuine dispute of material fact existed.[43] Perhaps more importantly, bankruptcy courts rejected *Johnston Hawks* and *Stroop* in favor of a more appealing alternative: the objective-basis standard.

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36 49 Bankr 823 (Bankr D Hawaii 1985).

37 51 Bankr 210 (Bankr D Colo 1985).

38 Ponoroff, 65 Ind L J at 335–38 (cited in note 21) (discussing *Johnston Hawks* and *Stroop* as the earliest decisions "relating to the bona fide dispute issue").

39 *Johnston Hawks*, 49 Bankr at 830.

40 See *Stroop*, 51 Bankr at 212. See also Brad R. Godshall and Peter M. Gilhuly, *The Involuntary Bankruptcy Petition: The World's Worst Debt Collection Device?*, 53 Bus Law 1315, 1327 (1998).

41 *Stroop*, 51 Bankr at 212.

42 See, for example, *In re Lough*, 57 Bankr 993, 996–97 (Bankr ED Mich 1986) ("The standard set forth in the *Johnston Hawks* case is unsatisfactory" in part because it "would disqualify a creditor when a debtor has a defense which he or she offers in subjective good faith but which objectively has little or no merit."). See also Kennedy, Bailey, and Clift, 31 U Memphis L Rev at 14–15 (cited in note 22).

43 See, for example, *Lough*, 57 Bankr at 997.

2. The *Lough/Busick* objective-basis standard.

The bankruptcy court in *In re Lough*[44] established the objective-basis standard for determining whether a bona fide dispute exists.[45] The *Lough* opinion began by summarizing and rejecting both the *Johnston Hawks* good faith standard and the *Stroop* summary judgment standard for the reasons described above.[46] The *Lough* court then set forth its own test: the objective-basis standard. The court held, "[I]f there is either a genuine issue of material fact that bears upon the debtor's liability, or a meritorious contention as to the application of law to undisputed facts, then the [involuntary bankruptcy] petition must be dismissed."[47] Thus, under the *Lough* standard, a bona fide dispute exists when there is a genuine dispute of material fact or law regarding a creditor's claim against the debtor. The *Lough* court was quick to emphasize, however, that in making such determinations bankruptcy courts "must not resolve any genuine issues of fact or law."[48] Bankruptcy courts may only determine whether a bona fide dispute exists.

The Seventh Circuit endorsed and refined the *Lough* standard in *In the Matter of Busick*.[49] The *Busick* court clarified that "[u]nder this standard, the bankruptcy court must determine whether there is an objective basis for either a factual or a legal dispute as to the validity of debt."[50] Like the *Lough* court, the Seventh Circuit specified that the objective-basis standard does not require a bankruptcy court to resolve the outcome of a genuine dispute. Instead, the standard merely requires a bankruptcy court to identify the "presence or absence" of an objective basis for a factual or legal dispute.[51]

Federal circuit courts have almost unanimously adopted the objective-basis standard for determining whether a bona fide dispute exists within the meaning of § 303. As one bankruptcy

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44 57 Bankr 993 (Bankr ED Mich 1986).

45 Id at 997. See also *In re Eastown Auto Co*, 215 Bankr 960, 965 (BAP 6th Cir 1998) ("*Lough* set forth the test for determining whether a claim is subject to a bona fide dispute.").

46 See *Lough*, 57 Bankr at 996–97. See also text accompanying notes 42–43.

47 *Lough*, 57 Bankr at 997.

48 Id.

49 831 F2d 745 (7th Cir 1987). See also Kennedy, Bailey, and Clift, 31 U Memphis L Rev at 13 (cited in note 22).

50 *Busick*, 831 F2d at 750.

51 Id, quoting *In the Matter of Busick*, 65 Bankr 630, 637 (ND Ind 1986).

court explained, "The *Lough/Busick* standard has been embraced by every circuit court that has confronted the 'subject to bona fide dispute' issue."[52] The Second, Third, Fourth, Fifth, Sixth, Seventh, Eighth, Ninth, and Tenth Circuits have explicitly adopted the objective-basis standard.[53] These courts have further clarified the standard's mechanics. Under the objective-basis standard, petitioning creditors bear the "burden of establishing a prima facie case that no bona fide dispute exists."[54] Once the creditors make this initial showing, the burden then shifts to the debtor to prove that a bona fide dispute exists.[55]

3. The objective-basis standard and other provisions of the Bankruptcy Code.

The term "bona fide dispute" also appears in § 363(f) of the Bankruptcy Code. The Code authorizes a trustee to use, sell, or lease a bankrupt debtor's property.[56] In this context, § 363(f) permits the sale of a debtor's property "free and clear of any interest in such property of an entity other than the estate" only if certain conditions are met.[57] One condition is that the asserted interest "is in bona fide dispute."[58]

As in § 303, the term "bona fide dispute" is not defined in § 363(f). Courts have acknowledged that the term likely has the

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52 *In re Smith*, 243 Bankr 169, 180 (Bankr ND Ga 1999). See also Susan Block-Lieb, *Why Creditors File So Few Involuntary Petitions and Why the Number Is Not Too Small*, 57 Brooklyn L Rev 803, 824 (1991) ("[C]ourts have concluded that debt is subject to a 'bona fide' dispute if an objective basis exists from which to conclude that the debtor's dispute as to the validity of the debt is supported either by a substantial question of fact or a meritorious issue of law.").

53 See *In re BDC 56 LLC*, 330 F3d 111, 117–18 (2d Cir 2003); *B.D.W. Associates, Inc v Busy Beaver Building Centers, Inc*, 865 F2d 65, 66–67 (3d Cir 1989); *Atlas Machine & Iron Works, Inc v Bethlehem Steel Corp*, 986 F2d 709, 715 (4th Cir 1993); *In the Matter of Sims*, 994 F2d 210, 220–21 (5th Cir 1993); *Eastown Auto Co*, 215 Bankr at 965 (6th Cir); *Busick*, 831 F2d at 750 (7th Cir); *In re Rimell*, 946 F2d 1363, 1365 (8th Cir 1991); *In re Vortex Fishing Systems, Inc*, 277 F3d 1057, 1064 (9th Cir 2002); *Bartmann v Maverick Tube Corp*, 853 F2d 1540, 1543–44 (10th Cir 1988).

54 *Sims*, 994 F2d at 221.

55 See *Rimell*, 946 F2d at 1365 ("[T]he petitioning creditor must establish a prima facie case that no bona fide dispute exists. Once this is done, the burden shifts to the debtor to present evidence demonstrating that a bona fide dispute does exist."); *Bartmann*, 853 F2d at 1544 ("Once the petitioning creditor establishes a prima facie case that its claim is not subject to a bona fide dispute, the burden shifts to the debtor to present evidence of a bona fide dispute."). See also Kennedy, Bailey, and Clift, 31 U Memphis L Rev at 15–16 (cited in note 22).

56 11 USC § 363(b)–(c).

57 11 USC § 363(f).

58 11 USC § 363(f)(4).

same meaning in both §§ 303 and 363(f).[59] As a result, bankruptcy courts determining whether a bona fide dispute exists within the meaning of § 363(f) look to *Busick* and use the same objective-basis standard employed in deciding whether a bona fide dispute exists under § 303.[60] Thus, the judicial interpretations of § 363(f) offer little guidance in interpreting the bona fide dispute requirement in § 303.

E. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005

Prior to 2005, courts applying the objective-basis standard were uncertain whether the debtor, in order to avoid involuntary bankruptcy, had to dispute the very existence of the creditors' claim or merely the amount of the claim.[61] Congress resolved this issue by passing the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005[62] (BAPCPA). Section 1234 of BAPCPA amended § 303 by inserting "as to liability or amount" immediately after "bona fide dispute" in § 303(b)(1) and "as to liability or amount" shortly after "bona fide dispute" in § 303(h)(1).[63] The House Report succinctly summarized the effect of the amendment:

> Section 1234 of the Act amends the Bankruptcy Code's criteria for commencing an involuntary bankruptcy case. Current law renders a creditor ineligible if its claim is contingent as to liability or the subject of a bona fide dispute. This provision amends section (303)(b)(1) to specify that a creditor would be ineligible to file an involuntary petition if the

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59 See, for example, *In re Octagon Roofing*, 123 Bankr 583, 590 (Bankr ND Ill 1991) (noting that "[n]o authority has been cited showing that 'bona fide dispute' has any different meaning when used in 11 USC § 363(f)(4)").

60 See id, citing *Busick*, 831 F2d at 750; *In re MMH Automotive Group, LLC*, 385 Bankr 347, 370 (Bankr SD Fla 2008); *In re Gaylord Grain LLC*, 306 Bankr 624, 627–28 (BAP 8th Cir 2004); *In re Gulf States Steel, Inc of Alabama*, 285 Bankr 497, 507–08 (Bankr ND Ala 2002); *In re Taylor*, 198 Bankr 142, 162 (Bankr D SC 1996) ("Courts applying § 363(f)(4) have developed a standard for determining whether a 'bona fide dispute' exists; that is whether there is an objective basis for either a factual or legal dispute as to the validity of the asserted interest."). See also Robert M. Zinman, *Precision in Statutory Drafting: The* Qualitech *Quagmire and the Sad History of § 365(h) of the Bankruptcy Code*, 38 John Marshall L Rev 97, 133 (2004).

61 See 2 *Collier on Bankruptcy* ¶ 303.11[2] at 303-33 (Matthew Bender 16th ed 2013) (Alan N. Resnick and Henry J. Sommer, eds).

62 Pub L No 109-8, 119 Stat 23, codified at 11 USC § 303(b)(1), (h)(1).

63 BAPCPA § 1234(a)(1)–(2), 119 Stat at 204.

> creditor's claim was the subject of a bona fide dispute as to liability or amount.[64]

Other than this statement, neither BAPCPA nor the surrounding legislative debates further clarified the meaning of § 303.[65]

Although the modification seems minor, the bona fide dispute requirement, as amended, substantially benefits debtors by making it easier for an alleged debtor to dispute a creditor's claim.[66] Under the new language, a debtor need dispute only the amount of the claim, not the claim's existence, to block a creditor from proceeding with an involuntary petition. Like BAFJA,[67] BAPCPA thus appears to suggest that the purpose of the bona fide dispute requirement is to protect debtors.

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The preceding discussion reveals two points. First, two competing goals underlie involuntary bankruptcy and the bona fide dispute requirement: one favoring creditors and another favoring debtors.[68] On the one hand, the general purpose of involuntary bankruptcy as a debt-collection device protects creditors' interests. Involuntary bankruptcy encourages creditors to seek payment collectively from debtors and discourages creditors from racing to exercise individual collection remedies. On the other hand, BAFJA and BAPCPA evince a goal to protect debtors. Both amendments suggest that the purpose of the bona fide dispute requirement is to prevent creditors from coercing or harassing debtors that genuinely dispute the existence or

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64 *Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, HR Rep No 109-31, 109th Cong, 1st Sess 149 (2005), reprinted in 2005 USCCAN 88, 207.

65 See 2 *Collier on Bankruptcy* ¶ 303.11[1] at 303-31, 303-33 (cited in note 61):

> The application of the objective standard has presented courts with considerable difficulty, some of which may diminish with [BAPCPA's] added language "as to liability or amount." . . . Many courts seem to conclude that it is self-evident that the amendments change the analysis and that even a dispute as to part of the claim disqualifies the creditor.

66 See Elijah M. Alper, Note, *Opportunistic Informal Bankruptcy: How BAPCPA May Fail to Make Wealthy Debtors Pay Up*, 107 Colum L Rev 1908, 1934 (2007) ("Though widely viewed as a creditor-friendly law, BAPCPA modified involuntary bankruptcy procedures to the benefit of debtors.").

67 See Part I.C.

68 See Ponoroff, 65 Ind L J at 360 (cited in note 21) (noting "the inherent tension between an innocent debtor's interest in being free from the havoc wreaked by a nonmeritorious petition and the creditors' equally compelling interest in obtaining the protections and safeguards afforded by bankruptcy relief before the debtor's assets have been irretrievably dissipated").

amount of their claims. Second, despite these competing goals, federal courts have essentially reached a consensus that the objective-basis standard is the appropriate test for determining whether a bona fide dispute exists for the purposes of involuntary bankruptcy proceedings. With these two points in mind, the next Part turns to how courts have applied the bona fide dispute requirement to unstayed state court judgments on appeal.

II. THE *DREXLER* RULE, THE *BYRD* RULE, AND THE *MARCIANO* DECISION

Despite widespread agreement among courts that the objective-basis standard is the correct test for determining whether a bona fide dispute exists within the meaning of § 303, all is not well in the world of federal bankruptcy. Significant disagreement exists concerning how the objective-basis standard applies when the creditors' claims against the debtor include unstayed state court judgments on appeal. It is unclear whether the appeal of such judgments can provide an objective basis to dispute the existence or amount of a state court judgment. The question has serious implications for creditors and debtors. If the appeal of an unstayed state court judgment *cannot* create a bona fide dispute, then creditors can initiate involuntary bankruptcy proceedings against a debtor despite the pending appeal. If the appeal *can* create a bona fide dispute, then petitioning creditors are unable to proceed with an involuntary bankruptcy petition until the appeal is resolved. Answering the question thus determines whether creditors can force a debtor into federal bankruptcy court against the debtor's will.

This Part describes the existing judicial disagreement concerning whether the appeal of an unstayed state court judgment can create a bona fide dispute within the meaning of § 303. By way of prelude, the disagreement consists of three representative decisions. In 1986, the United States Bankruptcy Court for the Southern District of New York in *In re Drexler*[69] established a per se rule that the appeal of an unstayed federal court judgment *cannot* create a bona fide dispute.[70] In 2004, the Fourth Circuit in *In re Byrd*[71] became the first federal court of appeals

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69 56 Bankr 960 (Bankr SDNY 1986).

70 See id at 967.

71 357 F3d 433 (4th Cir 2004).

to address the related question of whether the appeal of an unstayed state court judgment can create a bona fide dispute. The Fourth Circuit explicitly rejected *Drexler* and instead held that the existence of an unstayed state court judgment creates a rebuttable presumption that no bona fide dispute exists.[72] Under the *Byrd* approach, the appeal of an unstayed state court judgment *can* create a bona fide dispute if the debtor successfully rebuts the presumption that no such dispute exists.[73] In 2013, the Ninth Circuit in *In re Marciano*[74] explicitly rejected the Fourth Circuit's approach, thereby creating a circuit split. Purporting to adopt the *Drexler* rule, the Ninth Circuit adopted a per se rule that the appeal of an unstayed state court judgment can never create a bona fide dispute.[75] Federal bankruptcy courts continue to line up on both sides of the debate.

A. The *Drexler* Per Se Rule

Drexler was the first case to address whether the appeal of an unstayed judgment creates a bona fide dispute within the meaning of § 303.[76] In prior proceedings, a federal district court had entered two judgments against William Drexler.[77] Drexler appealed both judgments. While his appeal was pending, the victorious plaintiffs filed an involuntary bankruptcy petition against Drexler in federal bankruptcy court.[78] Drexler objected to the petition, contending, among other things, that his appeal of the trial court's judgments created a bona fide dispute, thereby rendering the plaintiffs ineligible to commence an involuntary proceeding.[79] The bankruptcy court considered "whether a petitioner's claim is the subject of a bona fide dispute if it is based on an unstayed final judgment from which an appeal by the debtor has been taken and is pending when the petition is filed."[80]

The court's analysis proceeded in three steps. First, the court considered legislative history. Congress had enacted BAFJA just two years prior, which amended § 303 and added

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72 Id at 438.
73 Id at 439. See also Part II.B.
74 708 F3d 1123 (9th Cir 2013).
75 See id at 1126.
76 *Drexler*, 56 Bankr at 960.
77 Id at 961–62.
78 Id at 961.
79 Id at 967.
80 *Drexler*, 56 Bankr at 967.

the bona fide dispute requirement.[81] The court noted that the legislative history was unhelpful because "[t]he amendment [to § 303] was not among the much debated proposals that preceded the enactment of BAFJA."[82] Accordingly, the legislative record failed to evince congressional intent and offered little interpretive guidance. The court also concluded that pre-BAFJA cases interpreting § 303 were of "limited usefulness" since the bona fide dispute requirement did not then exist.[83]

Second, the court turned to two post-BAFJA cases: *Stroop* and *Johnston Hawks*.[84] With little explanation, the court refrained from adopting the *Stroop* summary judgment standard.[85] Much like the *Lough* court, the *Drexler* court rejected the *Johnston Hawks* good faith standard on the ground that it required an inappropriate "determination of the debtor's subjective good faith."[86] The *Drexler* court further noted that, even were it to adopt either the *Stroop* summary judgment standard or the *Johnston Hawks* good faith standard, neither would apply because those cases presented different procedural postures than the case at hand.[87] The *Drexler* court concluded that neither *Stroop* nor *Johnston Hawks* controlled its interpretation of § 303.[88]

Finally, the court offered its own interpretation of § 303. The court's interpretation focused on the general effect of unstayed final judgments. The court reasoned that "[i]t would be contrary to the basic principles respecting, and would effect a radical alteration of, the long-standing enforceability of unstayed final judgments to hold that the pendency of the debtor's appeal created a 'bona fide dispute' within the meaning of Code § 303."[89] Relying on the general enforceability of unstayed final judgments, the *Drexler* court concluded:

> [A] claim based upon an unstayed judgment as to which an appeal has been taken by the debtor is *not the subject of a bona fide dispute*. Once entered, an unstayed final judgment

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81 See id at 965–66. See also Part I.C.

82 *Drexler*, 56 Bankr at 965–66.

83 Id at 966.

84 See Part I.D.1.

85 See *Drexler*, 56 Bankr at 966.

86 Id at 967.

87 Id at 966–67.

88 Id.

89 *Drexler*, 56 Bankr at 967.

> may be enforced in accordance with its terms and with applicable law or rules, even though an appeal is pending.[90]

In other words, under the *Drexler* rule, the appeal of an unstayed federal court judgment *cannot* create a bona fide dispute for the purposes of § 303.

Notably, *Drexler* was decided less than a month before *Lough*, which established the objective-basis standard.[91] Accordingly, it is not entirely clear how the *Drexler* and *Lough* decisions interact or whether the *Drexler* rule is even consistent with the objective-basis standard. Nonetheless, many courts appear to find no conflict in simultaneously applying the *Drexler* rule and the objective-basis standard. Indeed, in the years that followed, federal bankruptcy courts largely adhered to the *Drexler* rule and extended it to unstayed state court judgments.[92] Despite wide acceptance by federal bankruptcy courts for nearly two decades, no federal circuit court addressed—in a published opinion[93]—the related issue whether the appeal of an unstayed state court judgment can create a bona fide dispute for purposes of § 303.

B. The *Byrd* Rebuttable Presumption Rule

In 2004, the Fourth Circuit in *Byrd* became the first federal court of appeals to publish an opinion on "whether an unstayed state court judgment that is pending appeal can constitute a 'bona fide dispute' for purposes of the Bankruptcy Code."[94] Unlike *Drexler*, which concerned a prior federal court judgment, *Byrd* involved a state court judgment. A Maryland state court had entered multiple judgments against Ralph Byrd, who later appealed.[95] While Byrd's appeal was pending, the plaintiff from the prior proceeding filed a single-creditor involuntary bankruptcy

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90 Id (emphasis added).

91 *Drexler* was decided on January 29, 1986. *Lough* was decided on February 24, 1986. For a discussion of *Lough*, see Part I.D.2.

92 See, for example, *In re Euro-American Lodging Corp*, 357 Bankr 700, 712 (Bankr SDNY 2007); *In re Norris*, 183 Bankr 437, 452–54 & n 17 (Bankr WD La 1995); *In re Raymark Industries, Inc*, 99 Bankr 298, 300 (Bankr ED Pa 1989); *In re Caucus Distributors, Inc*, 83 Bankr 921, 929 (Bankr ED Va 1988); *In re Galaxy Boat Manufacturing Co*, 72 Bankr 200, 202 (Bankr D SC 1986). But see *In re Byrd*, 357 F3d 433, 438 (4th Cir 2004).

93 A Fifth Circuit panel followed the *Drexler* rule in an unpublished per curiam opinion. *In re Norris*, 1997 WL 256808, *5 (5th Cir) (per curiam) (holding that an unstayed state court judgment on appeal was not subject to a bona fide dispute).

94 *Byrd*, 357 F3d at 435–36.

95 Id at 436.

petition in federal bankruptcy court.[96] Byrd objected on the ground that his appeal of the state court judgments constituted a "bona fide dispute" for purposes of § 303.[97]

In its analysis, the Fourth Circuit began by noting that the federal circuit courts unanimously adhere to the *Lough/Busick* objective-basis standard.[98] Under that standard, a bona fide dispute exists for the purposes of § 303 only if there is "an objective basis for either a factual or a legal dispute as to the validity of [the] debt."[99] In light of the objective-basis standard, the *Byrd* court rejected *Drexler*, finding that the appeal of an unstayed state judgment may provide an objective basis for either a factual or legal dispute as to the validity of the creditor's claim.[100] While the court concluded that an unstayed state court judgment provides evidence of the absence of a bona fide dispute, "[s]uch judgments do not guarantee the lack of a bona fide dispute."[101] As a result, the Fourth Circuit held that an unstayed state court judgment merely creates a presumption that no bona fide dispute exists.[102] The court further held that the debtor may rebut that presumption by establishing that an appeal provides an objective basis to dispute the factual or legal validity of the unstayed state court judgment.[103]

To justify its approach, the Fourth Circuit relied on the specific purpose of the bona fide dispute requirement. The court explained that "the purpose of the 'bona fide dispute' provision is to prevent creditors from using involuntary bankruptcy 'to coerce a debtor to satisfy a judgment even when substantial questions may remain concerning the liability of the debtor.'"[104] The Fourth Circuit appeared to believe that its approach in *Byrd* protects debtors by preventing creditors from using involuntary bankruptcy coercively, thus better achieving the purpose of the bona fide dispute requirement. Furthermore, the Fourth Circuit reasoned that the per se approach in *Drexler* failed to appropriately

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96 Id at 437.

97 Id.

98 *Byrd*, 357 F3d at 437.

99 Id, quoting *Busick*, 831 F2d at 750 (quotation marks omitted).

100 See *Byrd*, 357 F3d at 438.

101 Id.

102 See id.

103 See id at 439.

104 *Byrd*, 357 F3d at 438, quoting *In re Prisuta*, 121 Bankr 474, 476 (Bankr WD Pa 1990).

protect debtors from coercive creditors. According to the Fourth Circuit, a per se rule would induce creditors to quickly reduce their claims to judgment in state court "and then automatically seek enforcement in bankruptcy."[105] *Byrd*'s rebuttable presumption approach prevents creditors from automatically obtaining the benefits of federal bankruptcy solely on the basis of a state court judgment.

After establishing this rebuttable presumption approach, the Fourth Circuit proceeded to apply the standard to the facts of Byrd's case and described the type of evidence that a debtor might proffer to rebut the presumption that no bona fide dispute exists. The court found that Byrd had not proffered any evidence to rebut the presumption.[106] Byrd had not provided, for example, "any credit card billing statements that showed unjustified finance charges" or "any documentation showing that he had paid such allegedly improper charges."[107] He also provided no evidence to challenge the creditor's showing that Byrd owed the amounts in dispute.[108] In light of Byrd's complete failure to proffer evidence to rebut the presumption, the Fourth Circuit concluded that the creditor's unstayed state court judgments were not subject to a bona fide dispute.[109]

Prior to 2004, some bankruptcy courts followed the approach ultimately set forth in *Byrd*, holding that the appeal of an unstayed state court judgment may create a bona fide dispute.[110] Following the Fourth Circuit's decision in 2004, several other courts adopted the *Byrd* rule.[111] Courts are especially sympathetic to the *Byrd* approach in cases with default judgments, in which the debtor did not argue on the merits in the state trial court.[112] One court, in adopting a *Byrd*-like rule, suggested that

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105 *Byrd*, 357 F3d at 438.

106 See id at 439–40.

107 Id at 440.

108 See id.

109 *Byrd*, 357 F3d at 440 ("Byrd has offered nothing more than his belief that he paid more than the principal amount . . . but a debtor's subjective beliefs do not give rise to a bona fide dispute.").

110 See, for example, *In re Prisuta*, 121 Bankr at 476.

111 See, for example, *In re Fustolo*, 503 Bankr 206, 219 (Bankr D Mass 2013) ("[T]his Court shall apply the *Byrd* rule under the circumstances of this case."). See also *In re Soderberg and Schafer CPAS, LLC*, 441 Bankr 262, 265 (ND Ohio 2010); *In re Graber*, 319 Bankr 374, 377–78 (Bankr ED Pa 2004).

112 See, for example, *In re Murrin*, 461 Bankr 763, 772 (Bankr D Minn 2012) ("Most of the pronouncements in this line come out of judgments entered by default or by inadvertence, and not on the merits.").

"a default judgment where facts were not actually litigated" could provide "objective circumstances that might give rise to a bona fide dispute as to liability or amount."[113] Despite being the first circuit court decision to address the question, *Byrd* remains the minority rule. Many courts have been critical of the *Byrd* approach on the ground that it fails to adequately respect lower court decisions.[114]

C. *Marciano* and the Circuit Split

In *Marciano*, a 2013 decision, the Ninth Circuit considered whether the appeal of an unstayed state court judgment can create a bona fide dispute for the purpose of involuntary bankruptcy.[115] The court described the issue as "a question of first impression in this court: Under [§ 303], is an unstayed state judgment on appeal *per se* a 'claim against [the debtor] that is not contingent as to liability or the subject of a bona fide dispute as to liability or amount?'"[116] The creditors in *Marciano* secured California state court judgments against Georges Marciano for tort claims of defamation and intentional infliction of emotional distress.[117] Marciano appealed. While the appeal was pending, Marciano's creditors filed an involuntary bankruptcy petition in federal bankruptcy court on the basis of the unstayed state court judgments.[118] Marciano objected to the petition, arguing that his

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[113] *In re Henry S. Miller Commercial, LLC*, 418 Bankr 912, 921–22 (Bankr ND Tex 2009) ("An appeal alone does not create a bona fide dispute. But a highly specialized fact pattern can conceivably guide a court to make an exception to the general rule recognizing the finality/enforceability of an unstayed judgment."). See also *In re Briggs*, 2008 WL 190463, *2 (Bankr ND Tex) ("The fact that the Judgment is unstayed and enforceable does not end the analysis of whether a bona fide dispute exists . . . . The Court can probe into the arguments being urged on appeal.").

[114] See, for example, *In re AMC Investors, LLC*, 406 Bankr 478, 485 (Bankr D Del 2009) ("[*Byrd*'s] approach is unnecessarily intrusive into the trial court's ruling and undermines the objective analysis of bona fide disputes. In effect, *Byrd* turns the court into an odds maker on appellate decision-making."); *In re Smith*, 415 Bankr 222, 229–31 (Bankr ND Tex 2009) (declining to "look behind the state court judgment"). See also *In re C.W. Mining Co*, 2009 WL 4798264, *5 (BAP 10th Cir) ("[A] federal district court judgment is entitled to full faith and credit in a bankruptcy court, absent the most extraordinary of circumstances.").

[115] *Marciano*, 708 F3d at 1124.

[116] Id, quoting 11 USC § 303(b)(1).

[117] *Marciano*, 708 F3d at 1124.

[118] Id at 1125.

appeal of the state court judgments constituted a bona fide dispute for purposes of § 303.[119]

The Ninth Circuit explicitly rejected the Fourth Circuit's approach in *Byrd* and claimed to adopt the *Drexler* rule, thereby creating a circuit split: "With appropriate deference to our sister circuit, we conclude that the *Drexler* rule is correct as a matter of both statutory interpretation and federalism."[120]

1. The majority opinion in *Marciano.*

The Ninth Circuit's argument proceeded in four steps. First, the court began with an analysis of the Bankruptcy Code's language. The Bankruptcy Code defines "claim" as a "right to payment, whether or not such right is reduced to judgment."[121] Given this language, the court concluded that the term "claim" includes judgments.[122] The court found that the creditors' claims against Marciano consisted of the judgments themselves and that the creditors "had fully vested property interests in these claims under California law."[123] In short, under state law, there was no reason to treat the judgments as contingent as to liability or amount despite the pending appeal.

Second, the court turned to the objective-basis standard. Like the Fourth Circuit, the Ninth Circuit adheres to the *Lough/Busick* objective-basis standard.[124] Unlike the Fourth Circuit, the *Marciano* court found that the appeal of an unstayed state court judgment did not provide an objective basis to dispute the amount or liability of a claim. In fact, the court found it "difficult to imagine a more 'objective' measure of the validity of a claim than an unstayed judgment entered by a court of competent jurisdiction."[125] According to the court, to hold otherwise would allow, or perhaps even require, federal courts to inappropriately second-guess state trial courts on matters of state law. The court argued that the application of the *Byrd* rule "[will] almost always [ ] turn on a judgment by an Article I federal court as to whether a state trial court erred as a matter of

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119 Id at 1125–26.

120 Id at 1126.

121 *Marciano*, 708 F3d at 1126–27, quoting 11 USC § 101(5)(A).

122 *Marciano*, 708 F3d at 1127.

123 Id.

124 See id at 1130. See also *In re Vortex Fishing Systems, Inc*, 277 F3d 1057, 1062 (9th Cir 2001) ("We adopt the objective test used by the other circuits.").

125 *Marciano*, 708 F3d at 1127.

state law," and that this approach "cannot be more 'objective' than simply honoring the unstayed state judgment."[126]

Third, the court concluded that the *Byrd* rule "runs counter to principles of federalism."[127] The full faith and credit statute requires federal courts to give state court judgments the same effect that state courts would give to their own judgments.[128] The Ninth Circuit reasoned that the *Byrd* rule fails to give state court judgments their full effect:

> [The full faith and credit statute] requires a federal court to accord the judicial proceedings of a state court "the same full faith and credit in every other court within the United States . . . as they have by law or usage in the courts of such State." . . . Such "full faith and credit" would be of little consequence if a federal court treated a non-default unstayed state judgment differently than it would be treated in its state of origin. If the creditor is entitled to have the judgment treated as valid in the state courts, we see no reason why a bankruptcy court should be allowed to question the judgment.[129]

The Ninth Circuit concluded that a per se rule—that the appeal of a state court judgment never creates a bona fide dispute—better respects state court judgments than does the *Byrd* rule.

Finally, the Ninth Circuit turned to the general purpose of involuntary bankruptcy. As discussed previously, one goal of involuntary bankruptcy is "to protect the threatened depletion of assets or to prevent the unequal treatment of similarly situat[ed] creditors."[130] Insofar as creditors that have reduced their claims to judgment may already use nonbankruptcy enforcement mechanisms to collect their judgments, the Ninth Circuit reasoned that a per se rule prevents races to the courthouse and

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[126] Id. See also *Norris*, 1997 WL 256808 at *5 (noting that to hold that the appeal of a state court judgment can create a bona fide dispute "would require the bankruptcy court to review the state court judgment in order to predict [the debtor's] chance of success on appeal (which would be particularly troubling in that a state court judgment is at issue), and would undermine the objective standard").

[127] *Marciano*, 708 F3d at 1128.

[128] See 28 USC § 1738. The full faith and credit statute codifies the principles of the Full Faith and Credit Clause. US Const Art IV, § 1. See also note 190 and accompanying text.

[129] *Marciano*, 708 F3d at 1128, quoting 28 USC § 1738.

[130] *In re Manhattan Industries, Inc*, 224 Bankr 195, 200 (Bankr MD Fla 1997). For a discussion of the general purposes of involuntary bankruptcy, see Part I.A.

thus better achieves the purpose of involuntary bankruptcy. As the court explained:

> [T]he *Drexler* approach well serves a central purpose of the involuntary bankruptcy laws—to protect the threatened depletion of assets or to prevent the unequal treatment of similarly situat[ed] creditors. . . . When a bankruptcy court prevents holders of unstayed state judgments from invoking involuntary bankruptcy, the ready alternative is precisely what the Code seeks to avoid—creditors racing to the courthouse to dismember the debtor.[131]

Based on the foregoing, the Ninth Circuit, purporting to adopt *Drexler*'s per se rule, rejected the *Byrd* approach and held "that an unstayed non-default state judgment is not subject to a bona fide dispute for purposes of § 303(b)(1)."[132] The Ninth Circuit's approach leaves open the possibility that the appeal of an unstayed default judgment could create a bona fide dispute.

Given the relative youth of the *Marciano* opinion, few courts have had the opportunity to address it. Courts within the Ninth Circuit have acknowledged that *Marciano* controls their interpretation of § 303.[133] Some courts outside the Ninth Circuit have explicitly rejected *Marciano* in favor of *Byrd*.[134] Others still have attempted to avoid coming down in favor of either approach.[135] The resulting circuit split has thus created significant confusion outside the Fourth and Ninth Circuits. Bankruptcy courts and practitioners in other circuits remain uncertain which rule applies.[136]

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131 *Marciano*, 708 F3d at 1128 (quotation marks and citations omitted).

132 Id.

133 See, for example, *Montana Department of Revenue v Blixseth*, 2013 WL 5408668, *1 (D Nev) (stating that *Marciano* "will provide guidance to petitioning creditors, involuntary debtors, and bankruptcy courts by which to analyze the creditor's qualifications under [§ 303]"); *In re Lesso*, 2013 WL 1943455, *4 (BAP 9th Cir), citing *Marciano*, 708 F3d at 1128 ("As a matter of comity and federalism, [courts] generally must give deference to state court judgments and proceedings."); *In re Imagine Fulfillment Services, LLC*, 489 Bankr 136, 150 n 4 (CD Cal 2013).

134 See, for example, *Fustolo*, 503 Bankr at 219–20.

135 See, for example, *In re Wishgard, LLC*, 2013 WL 1774707, *8 n 7 (WD Pa) (noting that "the split in case law as to whether even an unstayed *non-default* judgment on appeal is alone sufficient to guarantee the lack of a bona fide dispute" and acknowledging that "the interpretation of § 303(b) has divided courts," but refraining from adopting either the *Byrd* or *Marciano* approach).

136 See Deborah L. Thorne and Timothy S. McFadden, *A Circuit Split Unfolds on Unstayed Judgments Pending Appeal*, 32 Am Bankr Inst J 56, 57, 84 (May 2013) ("The *Marciano* decision creates a circuit split regarding . . . whether unstayed state court judgments may be the subject of a bona fide dispute."). See also Paul R. Hage, Aaron M.

2. The dissenting opinion in *Marciano*.

Judge Sandra Ikuta wrote a dissenting opinion in *Marciano* criticizing the majority's adoption of *Drexler*'s per se rule. Ikuta objected to the majority opinion on numerous grounds. First, she contended that the *Drexler* approach failed to give proper credence to the objective-basis standard.[137] With little explanation, she pronounced that the objective-basis standard is inconsistent with the per se rule embraced by the majority.[138]

Second, Ikuta rejected the majority's federalism argument. She argued that the "question whether a determination is *subject to* a genuine dispute is separate from determining the merits of that dispute."[139] While a federal court's resolution of a genuine dispute of state law would violate the full faith and credit statute, the determination that such a dispute merely exists, Ikuta argued, would not violate the statute:

> In short, determining whether a claim based on a state court judgment is subject to a bona fide dispute does not require us to relitigate any issue decided in a state court proceeding. Therefore, the natural reading of § 303(b)(1), under which federal bankruptcy courts must determine whether such a bona fide dispute exists, is entirely consistent with the [full faith and credit statute].[140]

Finally, Ikuta objected to the majority's purposive argument. Siding with the Fourth Circuit, Ikuta concluded that the legislative history "suggest[s] that the 'bona fide dispute' language was added to protect debtors from threats of involuntary bankruptcy by creditors holding claims of questionable validity."[141] Based on these objections, Ikuta concluded that the court should have adopted *Byrd* and rejected the *Drexler* per se rule.[142]

Kaufman, and Thomas Rice, *Can Holder of an Unstayed State Court Judgment Be a Petitioning Creditor?*, 32 Am Bankr Inst J 6, 6 (Aug 2013).

137 See *Marciano*, 708 F3d at 1132 (Ikuta dissenting).

138 See id at 1132–33 (Ikuta dissenting).

139 Id at 1133 (Ikuta dissenting).

140 Id at 1134 (Ikuta dissenting).

141 *Marciano*, 708 F3d at 1134 (Ikuta dissenting).

142 See id at 1134–35 (Ikuta dissenting).

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The case law presents two approaches for determining whether the appeal of an unstayed state court judgment can create a bona fide dispute for purposes of involuntary bankruptcy proceedings. Under *Byrd*, the appeal *can* create a bona fide dispute within the meaning of § 303. Under *Marciano*, the appeal *cannot* create a bona fide dispute within the meaning of § 303.

The decisions reveal two further points. First, the objective-basis standard adopted by the circuit courts does not clearly determine whether the appeal of an unstayed state court judgment can create a bona fide dispute. Although both the Fourth and Ninth Circuits accept the objective-basis standard, they disagree about whether the objective-basis standard is consistent with the *Drexler* per se rule with respect to state court judgments on appeal. Second, the goals of involuntary bankruptcy and the bona fide dispute requirement pull in opposite directions. The purpose of the bona fide dispute requirement—protecting debtors by preventing creditors from using involuntary bankruptcy coercively—appears to support the *Byrd* approach, which allows a debtor's appeal to create a bona fide dispute. On the other hand, the general purpose of involuntary bankruptcy—encouraging creditors to act collectively while discouraging races to the courthouse to dismember the debtor—appears to support the *Marciano* approach, which makes it easier for creditors to join together in an involuntary bankruptcy petition. In short, the courts' interpretive and purposive arguments are not decisive.

III. A THIRD PATH: THE ISSUE PRECLUSION APPROACH

The Fourth and Ninth Circuits went to great lengths to justify the *content* of their respective rules, but neither court sought to justify the *type* of rule it adopted. Focusing on the type of rule a court might craft reveals a third path. Both *Marciano* and *Byrd* purport to adopt uniform federal rules to resolve whether the appeal of a state court judgment can create a bona fide dispute. However, the application of a uniform federal rule conflicts with well-established Supreme Court precedent that favors the adoption of *state law* as the federal rule of decision when federal statutes are incomplete. By adopting uniform federal rules, both courts failed to fully consider the extent to which state law can aid in resolving the issue.

Relying on these observations, this Part argues that federal bankruptcy courts should adopt state issue preclusion law as the federal rule of decision—rather than fashioning a uniform national rule—to determine whether an appeal of a state court judgment can create a bona fide dispute. Under the proposed approach, if the issue preclusion law of a given state treats appealed unstayed state court judgments as final for purposes of issue preclusion, then an appeal cannot create a bona fide dispute. If, on the other hand, the issue preclusion law of a given state does not treat appealed unstayed state court judgments as final for purposes of issue preclusion, then an appeal can create a bona fide dispute. The issue preclusion approach avoids the federalism concerns raised by both *Byrd* and *Marciano* while retaining certain features of both approaches.

A. Uniform Federal Rules and State Law

Both *Byrd* and *Marciano* purported to create uniform federal rules to resolve whether the appeal of a state court judgment can create a bona fide dispute. This Section argues that crafting a uniform federal rule in this context is both unnecessary and undesirable, and that federal courts should instead adopt state law as the federal rule of decision.

1. Statutory gap filling: *Kimbell Foods* and *Butner*.

Federal statutes are often incomplete: they contain significant gaps and undefined terms. When this occurs, federal courts must fill the statutory gap by selecting some rule of decision.[143] In deciding which rule of decision to select, federal courts generally have two choices. Courts may fashion a uniform federal rule of decision with national application, or they may adopt state law as the federal rule of decision.[144]

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[143] See Ronald H. Rosenberg, *The Ultimate Independence of the Federal Courts: Defying the Supreme Court in the Exercise of Federal Common Law Powers*, 36 Conn L Rev 425, 437 (2004) ("As a matter of perceived necessity, the federal courts find the common law power to fill the gaps in an incomplete statute."). For a general definition of "rule of decision," see *Black's Law Dictionary* at 1448 (cited in note 2) (defining "rule of decision" as a "rule, statute, body of law, or prior decision that provides the basis for deciding or adjudicating a case").

[144] See *United States v Kimbell Foods, Inc*, 440 US 715, 727–28 (1979), quoting *United States v Standard Oil Co*, 332 US 301, 310 (1947) ("Whether to adopt state law or to fashion a nationwide federal rule is a matter of judicial policy 'dependent upon a variety

In *United States v Kimbell Foods, Inc*,[145] the Supreme Court established a three-part balancing test for determining when federal courts should fashion uniform federal rules and when they should instead adopt state law as the federal rule of decision.[146] As the Ninth Circuit explained:

> Under the three-part test established in *Kimbell Foods*, [a federal court] must determine (1) whether the issue requires a nationally uniform body of law; (2) whether application of state law would frustrate specific objectives of the federal programs; and (3) whether application of a federal rule would disrupt commercial relationships predicated on state law.[147]

Applying this balancing test, the Supreme Court has held that when "a national rule is unnecessary to protect the federal interests underlying" a federal statute, federal courts must "adopt state law as the appropriate federal rule."[148] When federal courts interpret incomplete federal statutes, *Kimbell Foods* compels them to adopt state law as the federal rule of decision unless a uniform national rule is *necessary* to achieve the federal statute's purpose.[149]

The Bankruptcy Code, like other federal statutes, is incomplete. In *Butner v United States*,[150] the Supreme Court established

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of considerations always relevant to the nature of the specific governmental interests and to the effects upon them of applying state law.'").

[145] 440 US 715 (1979).

[146] Id at 728–29.

[147] *American International Enterprises, Inc v FDIC*, 3 F3d 1263, 1268 (9th Cir 1993) (quotation marks and citations omitted). See also *Gaff v FDIC*, 919 F2d 384, 388–89 (6th Cir 1990); *Resolution Trust Corp v Daddona*, 9 F3d 312, 318 (3d Cir 1993). For scholarly treatment of *Kimbell Foods*' three-part test, see J. Maxwell Tucker, *Substantive Consolidation: The Cacophony Continues*, 18 Am Bankr Inst L Rev 89, 130 (2010); Rosenberg, 36 Conn L Rev at 429 (cited in note 143); Aaron D. Weiner, Note, *Toward Adoption of State Law as the Federal Rule of Decision in Cases Involving Voluntary Federal Creditors*, 73 Minn L Rev 171, 181 (1988).

[148] *Kimbell Foods*, 440 US at 718. See also *Boyle v United Technologies Corp*, 487 US 500, 507–08 (1988) (reading *Kimbell Foods* as deciding that state law will apply when the *Kimbell Foods* test is met).

[149] See *Boyle*, 487 US at 507 ("[A]n area of unique[ ] federal interest . . . establishes a necessary, not a sufficient, condition for the displacement of state law."). See also Michael H. Schill, *Uniformity or Diversity: Residential Real Estate Finance Law in the 1990s and the Implications of Changing Financial Markets*, 64 S Cal L Rev 1261, 1280–81 n 96 (1991) ("In [*Kimbell Foods*], the Court held that in the absence of a congressional directive to the contrary, state law governs the relative priority of private and consensual liens arising from federal programs.").

[150] 440 US 48 (1979).

a standard for determining when federal courts should fashion uniform federal rules to fill gaps in the Bankruptcy Code and when they should instead adopt state law as the federal rule of decision. The *Butner* court held:

> Congress has generally left the determination of property rights in the assets of a bankrupt's estate to state law. Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding.[151]

Kimbell Foods, which was decided later in the same term as *Butner*, was designed to be consistent with this approach and cited *Butner*.[152] Butner stands for the proposition that "bankruptcy law should respect[ ] nonbankruptcy entitlements unless a particular bankruptcy policy is being vindicated."[153] When federal courts interpret incomplete portions of the Bankruptcy Code, *Butner*, like *Kimbell Foods*, compels them to adopt state law as the federal rule of decision unless a uniform national rule is necessary to achieve the Bankruptcy Code's purposes.[154]

2. An unnecessary and undesirable uniform federal rule.

Section 303 of the Bankruptcy Code is an incomplete federal statute insofar as "bona fide dispute" is undefined and the text, standing by itself, does not determine whether the appeal of a state court judgment can create a bona fide dispute. Federal courts interpreting § 303 must therefore fill the statutory gap by selecting some rule of decision. *Kimbell Foods* and *Butner* compel federal courts interpreting § 303 to adopt state law as the federal rule of decision unless some federal interest is vindicated by the application of a uniform national rule, or a uniform rule is necessary to achieve § 303's purpose.

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151 Id at 54–55.

152 *Kimbell Foods*, 440 US at 1465.

153 Douglas G. Baird, *Elements of Bankruptcy* 9 (Foundation 5th ed 2010).

154 See Juliet M. Moringiello, *(Mis)Use of State Law in Bankruptcy: The Hanging Paragraph Story*, 2012 Wis L Rev 963, 992 ("By stating that the [Bankruptcy] Code must respect state law property rights unless a federal interest dictates otherwise, *Butner* preserves state law as the source of bankruptcy entry rights.").

Despite the *Butner* presumption favoring the adoption of state law as the federal rule of decision in bankruptcy, both *Byrd* and *Marciano* purport to adopt uniform federal rules. *Byrd* adopts the uniform federal rule that the appeal of a state court judgment *can* create a bona fide dispute, while *Marciano* purports to adopt the uniform federal rule that the appeal of a state court judgment *cannot* create a bona fide dispute. In order to remain faithful to the *Butner* principle, *Marciano* and *Byrd* must show that a uniform federal rule is necessary to vindicate some federal interest underlying the Bankruptcy Code. Neither court argued that a uniform federal rule is necessary to achieve the Bankruptcy Code's purposes. However, as previously discussed, both the Fourth and Ninth Circuits claim that their respective approaches vindicate an important bankruptcy policy.[155] Although *Byrd* and *Marciano* correctly identify goals underlying the Bankruptcy Code, neither decision considered whether or to what extent its approach in fact achieves these goals in the specific context of unstayed state court judgments. Thus, to evaluate whether *Byrd* and *Marciano* appropriately adopt uniform federal rules, one needs to examine whether their approaches achieve their intended goals.

A closer examination reveals that the rules adopted in *Byrd* and *Marciano* do not achieve the federal purposes that the decisions claim to advance. The Fourth Circuit attempted to justify its rebuttable presumption approach based on the specific purpose of the bona fide dispute requirement. The court claimed that its approach prevents creditors from using involuntary bankruptcy to coerce debtors into paying disputed judgments.[156] Under *Byrd*, as long as the debtor can successfully rebut the presumption against her and show that her appeal creates a bona fide dispute, she can render the creditors ineligible to proceed with an involuntary bankruptcy petition. The problem with this explanation is that excluding judgment creditors from federal bankruptcy court does not prevent them from enforcing their claims by other means. Even if judgment creditors are excluded from involuntary bankruptcy, creditors can force debtors to pay disputed judgments using nonbankruptcy state court enforcement procedures. As one court explained, "[T]he array of state court enforcement procedures available to judgment creditors

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[155] See text accompanying notes 104–05, 130–31.

[156] *Byrd*, 357 F3d at 438.

outside of bankruptcy can and are used by those creditors to coerce payment."[157] Because it does not prevent judgment creditors from coercing debtors to pay disputed debts, the uniform federal rule adopted in *Byrd* fails to achieve the purpose underlying the bona fide dispute requirement.

The Ninth Circuit attempted to justify its per se approach based on the general purpose of involuntary bankruptcy. Specifically, the court claimed that its per se approach allows creditors to act collectively to pursue payment from a debtor through involuntary bankruptcy and deters creditors from individually collecting their money judgments through state court enforcement procedures. Under *Marciano*, if creditors reduce their claim to judgment, they can force the debtor into involuntary bankruptcy and collectively enforce their claims.[158] The problem here is that not all cases involving unstayed state court judgments implicate collective action problems. Consider the procedural posture in *Byrd*. The case involved a *single* petitioning creditor seeking to enforce its claims through involuntary bankruptcy.[159] In *Byrd*, like in all single-creditor cases, involuntary bankruptcy cannot "secure an equitable distribution of the assets" among multiple creditors,[160] "prevent the unequal treatment of similarly situat[ed] creditors,"[161] or "ensure an orderly ranking of creditors' claims"[162]—the central purposes of bankruptcy—because there is only a single creditor. In these types of cases, the uniform federal rule adopted in *Marciano* does not achieve the general purpose underlying involuntary bankruptcy.

The foregoing shows that the rules set forth in *Byrd* and *Marciano* do not always achieve the purposes that the decisions claim to advance. The *Byrd* rule does not necessarily prevent creditors from forcing debtors to pay disputed debts. *Marciano* does not achieve the general purposes underlying bankruptcy in cases that do not implicate collective action problems. The decisions do not identify any other federal interest that would justify the creation of a uniform federal rule in this context. Insofar as

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157 *In re AMC Investors, LLC*, 406 Bankr 478, 487 (Bankr D Del 2009) (quotation marks omitted).

158 See *Marciano*, 708 F3d at 1126–27.

159 *Byrd*, 357 F3d at 436.

160 *In re Arker*, 6 Bankr 632, 636 (Bankr EDNY 1980).

161 *In re Manhattan Industries, Inc*, 224 Bankr 195, 200 (Bankr MD Fla 1997).

162 *In re H.I.J.R. Properties Denver*, 115 Bankr 275, 279 (D Colo 1990) (quotation marks omitted).

the *Byrd* and *Marciano* rules do not accomplish their intended goals, the rules cannot possibly be necessary to achieve the federal interests underlying bankruptcy.[163] Accordingly, the decisions fail to demonstrate that a uniform federal rule is necessary to achieve the Bankruptcy Code's purposes. The fact that both courts purport to adopt uniform national rules therefore appears to be in tension with the reasoning of *Kimbell Foods* and *Butner*.

Consistent with these objections, *Byrd* has been criticized on the ground that it fails to respect state law and therefore violates the *Butner* principle.[164] Courts posing this criticism have focused on state court enforcement procedures available outside of bankruptcy.[165] Courts favoring *Drexler* and *Marciano* argue that the ability to enforce state court judgments through state court procedures implies that creditors should be equally able to enforce those judgments through federal bankruptcy mechanisms.[166]

Few courts and commentators, however, have noticed that *Marciano* also conflicts with *Butner*. *Marciano* purports to respect state law and, by extension, the *Butner* principle, by refusing to reconsider matters decided by state courts.[167] The problem is that, by creating a uniform federal rule that the appeal of an unstayed state court judgment can never create a bona fide dispute, *Marciano* ignores the extent to which state law already determines whether a federal court may reconsider an appealed state court judgment. Indeed, in many instances, state law permits a federal court to reconsider the issues decided by a state court when its judgment is appealed.[168] Under the law of many

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163 Even if the rules adopted in *Byrd* and *Marciano* achieved their intended goals, that would not show that the decisions satisfied *Butner* and *Kimbell Foods*. The decisions would have to show not only that the uniform rules achieve the federal interests underlying bankruptcy, but also that the uniform rules are *necessary* to achieve the federal interests underlying bankruptcy.

164 See, for example, *Marciano*, 708 F3d at 1127–28, citing *Butner*, 440 US at 55, 99 (noting that "property interests in bankruptcy proceedings are typically defined by state law," and stating that "the *Byrd* approach runs counter to principles of federalism"); *AMC Investors*, 406 Bankr at 486 ("[T]he analysis in *Byrd* runs counter to the *Butner* principle.").

165 See, for example, *AMC Investors*, 406 Bankr at 486 (stating that an "array of state court enforcement procedures available to judgment creditors outside of bankruptcy can and are used by those creditors to coerce payment") (quotation marks omitted).

166 See, for example, id.

167 See *Marciano*, 708 F3d at 1127, citing *Butner*, 440 US at 55.

168 See text accompanying notes 183–87.

states, an appealed state court judgment does not bind subsequent courts, including federal courts.[169]

Marciano appears to acknowledge that federal bankruptcy courts should look to state law to determine whether the appeal of an unstayed state court judgment can create a bona fide dispute. Despite purporting to have adopted the *Drexler* rule—the per se rule that the appeal of an unstayed judgment can *never* create a bona fide dispute—the Ninth Circuit's reasoning in *Marciano* did not commit the court to a uniform federal rule. Recall that *Drexler* involved whether the appeal of an unstayed *federal* court judgment creates a bona fide dispute.[170] *Marciano*, by contrast, involved whether the appeal of an unstayed *state* court judgment creates a bona fide dispute.[171] The Ninth Circuit correctly looked to state law to determine whether the appeal could create a bona fide dispute.[172] Despite applying state law to determine that the appeal of the state court judgment did not create a bona fide dispute, the Ninth Circuit cast its decision as a uniform federal rule, leaping to the conclusion that the appeal of a state court judgment can *never* create a bona fide dispute.[173] Nothing in the court's reasoning, however, compels a per se rule. Although the Ninth Circuit was correct to look to state law to determine whether an appeal can create a bona fide dispute, the court ultimately failed to follow this reasoning to its logical conclusion, which would require incorporating state law as the federal rule of decision.

To summarize, it is far from clear that a uniform federal rule in the context of § 303 vindicates any significant federal interest, nor is it clear that a uniform national rule is necessary to achieve the Bankruptcy Code's purposes. In the absence of a significant federal interest in a uniform national rule, *Kimbell Foods* and *Butner* compel federal courts interpreting § 303 and the bona fide dispute requirement to adopt state law as the federal rule of decision.

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169 See text accompanying notes 183–87.

170 See *Drexler*, 56 Bankr at 968. See also Part II.A.

171 See *Marciano*, 708 F3d at 1124. See also Part II.C.

172 See *Marciano*, 708 F3d at 1127 ("Under California law, these judgments, in the absence of a stay pending appeal, were plainly not contingent as to liability or amount.").

173 See id at 1128 ("We thus hold that an unstayed non-default state judgment is not subject to bona fide dispute for purposes of § 303(b)(1).").

B. State Issue Preclusion Law and Bona Fide Disputes

Federal courts interpreting § 303 can adopt state law as the federal rule of decision only to the extent that state law can resolve the question of whether an appeal creates a bona fide dispute. This Section aims to show that state issue preclusion law sufficiently determines what effect federal courts should generally give state court judgments and, specifically, the effect of an appeal on a judgment's finality. Accordingly, federal courts can and should adopt state issue preclusion law as the federal rule of decision to determine whether the appeal of a state court judgment can create a bona fide dispute. If an appeal does not render a judgment nonfinal under a state's issue preclusion rules, then the appeal cannot create a bona fide dispute. If an appeal does render a judgment nonfinal under a state's issue preclusion rules, then the appeal can create a bona fide dispute.

1. The doctrine of res judicata.

Res judicata is the "[d]octrine by which 'a final judgment by a court of competent jurisdiction is conclusive upon the parties in any subsequent litigation involving the same cause of action.'"[174] Res judicata comes in two forms: claim preclusion and issue preclusion.[175] Claim preclusion "foreclose[s] any litigation of matters that never have been litigated because of the determination that they should have been advanced in an earlier suit."[176] Issue preclusion, also known as collateral estoppel, is "the doctrine recognizing that the determination of facts litigated between two parties in a proceeding is binding on those parties in all future proceedings against each other."[177] The doctrine of issue preclusion is the focus of this Section.

Under the doctrine of issue preclusion, a court's final judgment in an earlier case binds the same parties in subsequent proceedings with respect to the same issues of law or fact.[178] The

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[174] Steven H. Gifis, *Law Dictionary* 464 (Barron's 6th ed 2010), quoting Milton D. Green, *Basic Civil Procedure* 227 (Foundation 2d ed 1979) (emphasis omitted).

[175] For background on res judicata, see Allan D. Vestal, *The Constitution and Preclusion/Res Judicata*, 62 Mich L Rev 33, 34 (1963); Allan D. Vestal, *Rationale of Preclusion*, 9 SLU L J 29, 29 n 3 (1964).

[176] Charles Alan Wright and Mary Kay Kane, *Law of Federal Courts* § 100A at 723 (West 7th ed 2011).

[177] Gifis, *Law Dictionary* at 92 (cited in note 174) (emphasis omitted).

[178] See *Allen v McCurry*, 449 US 90, 94 (1980) ("Under [issue preclusion], once a court has decided an issue of fact or law necessary to its judgment, that decision may

Restatement (Second) of Judgments provides, "When an issue of fact or law is actually litigated and determined by a valid and final judgment, and the determination is essential to the judgment, the determination is conclusive in a subsequent action between the parties, whether on the same or a different claim."[179] A party seeking to invoke issue preclusion must typically prove four[180] elements:

> (1) [T]he issue sought to be precluded must be the same as that involved in the prior litigation, (2) the issue must have been actually litigated, (3) the determination of the issue must have been essential to the final judgment, and (4) the party against whom estoppel is invoked must [have been] fully represented in the prior action.[181]

The element of finality is of special importance here. The Restatement (Second) of Judgments provides, "The rules of res judicata are applicable only when a final judgment is rendered. However, for purposes of issue preclusion . . . 'final judgment' includes any prior adjudication of an issue in another action that is determined to be sufficiently firm to be accorded conclusive effect."[182]

The doctrine of issue preclusion governs whether the appeal of a judgment renders that judgment nonfinal for purposes of issue preclusion. Jurisdictions disagree about whether an appeal renders

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preclude relitigation of the issue in a suit on a different cause of action involving a party to the first case.").

[179] Restatement (Second) of Judgments § 27 (1982).

[180] Courts sometimes enumerate the elements of issue preclusion differently, identifying more or fewer elements than the four described here. See, for example, *Collins v Pond Creek Mining Co*, 468 F3d 213, 217 (4th Cir 2006) (identifying five elements of issue preclusion); *Clark v Bear Stearns & Co*, 966 F2d 1318, 1320 (9th Cir 1992) (identifying three elements of issue preclusion). While the circuits may enumerate the elements differently, they "all apply some variation of the Restatement's test." Matthew A. Ferry, *Different Infringement, Different Issue: Altering Issue Preclusion as Applied to Claim Construction*, 19 Tex IP L J 361, 369 & n 35 (2011).

[181] *H-D Michigan, Inc v Top Quality Service, Inc*, 496 F3d 755, 760 (7th Cir 2007) (quotation marks and citations omitted). See also *Pfeil v State Street Bank and Trust Co*, 671 F3d 585, 601 (6th Cir 2012); *Howard Hess Dental Laboratories Inc v Dentsply International, Inc*, 602 F3d 237, 247–48 (3d Cir 2010); *Nichols v Board of County Commissioners of County of La Plata, Colorado*, 506 F3d 962, 967 (10th Cir 2007); *Christo v Padgett*, 223 F3d 1324, 1339 (11th Cir 2000); *In re Berr*, 172 Bankr 299, 306 (BAP 9th Cir 1994).

[182] Restatement (Second) of Judgments § 13 (1982).

a judgment nonfinal.[183] As a comment to the Restatement (Second) of Judgments notes, "There have been differences of opinion about whether, or in what circumstances, a judgment can be considered final for purposes of issue preclusion when proceedings have been taken to reverse or modify it by appeal."[184] Federal courts apply the rule that a judgment is final and has preclusive effect even while an appeal is pending—an appeal does not render a judgment nonfinal for purposes of issue preclusion.[185] The majority of states follow the federal rule.[186] The minority view is that the appeal of a judgment renders it nonfinal for purposes of issue preclusion.[187]

Issue preclusion also governs the effect of judgments that are later reversed on appeal. In most jurisdictions, even if a subsequent judgment relies on the preclusive effect of a prior judgment and the prior judgment is later reversed, the subsequent judgment remains effective. As the Restatement (Second) of Judgements provides, "A judgment based on an earlier judgment

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[183] For a survey of cases from various jurisdictions, see generally E.H. Schopler, *Judgment as Res Judicata Pending Appeal or Motion for a New Trial, or during the Time Allowed Therefor*, 9 ALR2d 984 (1950).

[184] Restatement (Second) of Judgments § 13, comment f (1982).

[185] See *Huron Holding Corp v Lincoln Mine Operating Co*, 312 US 183, 189 (1941) ("[I]n the federal courts the general rule has long been recognized that while appeal with proper supersedeas stays execution of the judgment, it does not—until and unless reversed—detract from its decisiveness and finality."); *Southern Pacific Communications Co v American Telephone & Telegraph Co*, 740 F2d 1011, 1018 (DC Cir 1984) ("We note that the federal rule and the rule in this circuit is that collateral estoppel may be applied to a trial court finding even while the judgment is pending on appeal.").

[186] See *Campbell v Lake Hallowell Homeowners Association*, 852 A2d 1029, 1039 (Md App 2004), quoting *O'Brien v Hanover Insurance Co*, 692 NE2d 39, 44 (Mass 1998) (stating that "this rule—that a pending appeal does not affect the finality of a judgment—is now 'followed by a majority of states,'" and collecting state cases that adopt the majority rule). For several recent state court opinions invoking the majority rule, see *Brown-Wilbert, Inc v Copeland Buhl & Co*, 732 NW2d 209, 220 (Minn 2007); *Smith v CSK Auto, Inc*, 132 P3d 818, 820 (Alaska 2006); *Cashion v Torbert*, 881 S2d 408, 414–15 (Ala 2003); *State v Harrison*, 61 P3d 1104, 1110 (Wash 2003) (en banc); *Lee v Mitchell*, 953 P2d 414, 420 n 11 (Or App 1998).

[187] See *Campbell*, 852 A2d at 1040 (noting that "[a] minority of states . . . have concluded that a lower court judgment is not 'final' for purposes of res judicata or collateral estoppel when it is on appeal," and collecting state cases that adopt the minority rule). For several state court opinions invoking the minority rule, see *Rantz v Kaufman*, 109 P3d 132, 141 (Colo 2005) (en banc); *Dupre v Floyd*, 825 S2d 1238, 1240–41 (La App 2002); *Jordache Enterprises, Inc v National Union Fire Insurance Co of Pittsburgh*, 513 SE2d 692, 703 (W Va 1998) (noting in passing that "[a]lthough this [c]ourt has never expressly held that a judgment pending appeal is not final for res judicata . . . purposes, it [has] intimated as much").

is not nullified automatically by reason of the setting aside, or reversal on appeal, or other nullification of that earlier judgment."[188]

2. The full faith and credit statute.

The Full Faith and Credit Clause reads: "Full Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State. And the Congress may by general Laws prescribe the Manner in which such Acts, Records and Proceedings shall be proved, and the Effect thereof."[189] Congress codified the "full faith and credit" principles in the full faith and credit statute.[190] The statute reads:

> The records and judicial proceedings of any court of any [ ] State, Territory or Possession, or copies thereof, shall be proved or admitted in other courts within the United States and its Territories and Possessions . . . [and] shall have the same full faith and credit in every court within the United States and its Territories and Possessions as they have by law or usage in the courts of such State, Territory or Possession from which they are taken.[191]

Under the full faith and credit statute, federal courts must apply state law to determine the effect of a state court judgment.[192] This means that in federal court, a state court judgment must have the same effect that it would otherwise have in state court.

The full faith and credit statute requires federal courts to apply state issue preclusion rules to determine the effect of state court judgments.[193] The Supreme Court has held that the statute

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188 Restatement (Second) of Judgments § 16 (1982).

189 US Const Art IV, § 1.

190 Act of June 25, 1948 § 1738, 62 Stat 869, 947, codified at 28 USC § 1738. See also *Migra v Warren City School District Board of Education*, 465 US 75, 80 (1984) ("The Constitution's Full Faith and Credit Clause is implemented by the federal full faith and credit statute.").

191 28 USC § 1738.

192 See *Marrese v American Academy of Orthopedic Surgeons*, 470 US 373, 381 (1985) ("[Section] 1738 requires a federal court to look first to state preclusion law in determining the preclusive effects of a state court judgment.").

193 See *Semler v Psychiatric Institute of Washington, DC, Inc*, 575 F2d 922, 930 (DC Cir 1978) ("[T]he *res judicata* effect of the first forum's judgment is governed by first forum's law . . . . Thus, the local law of the State where the judgment was rendered determines . . . what claims are extinguished by the judgment.") (quotation marks and citations omitted). Of course, a federal court sitting in diversity must apply "the choice-of-law rules of the state in which it sits." *Interfirst Bank Clifton v Fernandez*, 853 F2d 292, 294 (5th Cir 1988). Strictly speaking, then, a federal court does not necessarily apply the forum

"does not allow federal courts to employ their own rules of res judicata in determining the effect of state judgments. Rather, it . . . commands a federal court to accept the rules chosen by the State from which the judgment is taken."[194] This requirement extends to federal bankruptcy courts.[195]

State issue preclusion rules thus provide federal courts with the answer for determining whether a state court judgment on appeal is final. If the state adopts the majority rule, then the federal court must apply the rule that an appeal does not render the judgment nonfinal for preclusive purposes.[196] If the state adopts the minority rule, then the federal court must apply the rule that an appeal renders the judgment nonfinal for preclusive purposes.[197] In the event that a state's supreme court has not adopted a clear rule for whether an appeal renders a judgment nonfinal for purposes of issue preclusion, a federal court, following the principles set forth in *Erie Railroad Co v Tompkins*,[198] must predict how the state supreme court would rule on the issue.[199] Although courts sometimes recognize exceptions to the full faith and credit statute, the Supreme Court has held "that an exception to § 1738 will not be recognized unless a later statute contains an express or implied partial repeal."[200]

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state's issue preclusion law. Rather, a federal court must apply the issue preclusion law that the forum state would apply.

194 *Kremer v Chemical Construction Corp*, 456 US 461, 481–82 (1982). See also *Union & Planters' Bank of Memphis v City of Memphis*, 189 US 71, 75 (1903) ("[W]hat effect a judgment of a state court shall have as *res judicata* is a question of state or local law.").

195 See Note, *Developments in the Law Res Judicata*, 65 Harv L Rev 818, 884 (1952) ("With certain qualifications, the judgments of other courts are res judicata in bankruptcy proceedings."). See also *Heiser v Woodruff*, 327 US 726, 736 (1946) ("[T]he principles of *res judicata* preclude the revival of [ ] litigation in the bankruptcy court."); *In re Genesys Data Technologies, Inc*, 204 F3d 124, 129 (4th Cir 2000) (stating that "the argument that res judicata principles do not fully apply in the context of bankruptcy claims allowance proceedings" is "untenable"); *In re Nourbakhsh*, 162 Bankr 841, 843–44 (BAP 9th Cir 1994) (applying state issue preclusion law).

196 See *Migra*, 465 US at 81 ("[A] federal court must give to a state court judgment the same preclusive effect as would be given that judgment under the law of the State in which the judgment was rendered.").

197 See, for example, *Cruz v Melecio*, 204 F3d 14, 20 (1st Cir 2000) (applying Puerto Rico's rule "that a commonwealth court judgment cannot be accorded preclusive effect until all available appeals have been exhausted").

198 304 US 64 (1938).

199 See, for example, *Ruyle v Continental Oil Co*, 44 F3d 837, 846 (10th Cir 1994) (predicting that the Oklahoma Supreme Court "would adopt the Restatement position on finality" and, therefore, concluding that an Oklahoma trial court judgment was final while an appeal was pending).

200 *Kremer*, 456 US at 468, citing *Allen*, 449 US at 99.

C. The Issue Preclusion Approach

The doctrine of issue preclusion, in conjunction with *Kimbell Foods* and the *Butner* principle, reveals a potential resolution to whether the appeal of a state court judgment can create a bona fide dispute within the meaning of § 303. Rather than adopting a uniform federal rule, federal bankruptcy courts should adopt state issue preclusion law as the federal rule of decision. Under the proposed approach, federal bankruptcy courts should look to the state's issue preclusion law in considering whether the appeal of an unstayed state court judgment can create a bona fide dispute within the meaning of § 303. Bankruptcy courts should then determine whether the state court would treat its own judgment as final for the purposes of issue preclusion during the pendency of an appeal.

1. Administering the issue preclusion approach.

In practice, the outcome of the issue preclusion approach will vary by state. In those states that have adopted the majority issue preclusion rule, the inquiry will be rather straightforward. In these states, a judgment is final, and therefore preclusive, during the pendency of an appeal. As noted above, federal courts must give the same effect to state court judgments that a state court would give the judgment.[201] If the state would treat a prior judgment as final and therefore binding on other state courts, then the federal bankruptcy court must likewise treat the judgment as final. In those states that have adopted the majority issue preclusion rule, the federal bankruptcy court is bound by the prior state court's judgment, and the appeal of an unstayed state court judgment will never create a bona fide dispute within the meaning of § 303.

In those states that have adopted the minority issue preclusion rule, the analysis will be more difficult. In these states, because the appeal of an unstayed state court judgment renders the judgment nonfinal for purposes of issue preclusion, an appeal can create a bona fide dispute. Following the ordinary burdens of proof, the petitioning creditors would have the initial burden to show that a bona fide dispute does not exist.[202] The existence of

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[201] See Part III.B.

[202] See notes 54–55 and accompanying text.

an unstayed state court judgment will create a presumption that no bona fide dispute exists, which will satisfy the creditors' initial burden. In states that have adopted the minority rule, the debtor can rebut the presumption by showing that their appeal creates a bona fide dispute. This is akin to the Fourth Circuit's approach in *Byrd*.[203] Note, however, that an appeal will not *automatically* create a bona fide dispute under the minority rule. Instead, in states that adopt the minority rule, the issue preclusion approach requires federal courts to engage in further analysis to determine whether a bona fide dispute exists. As *Byrd* suggests, to successfully rebut the presumption, the debtor might proffer invoices indicating that the debt is unjustified or documentation showing that the debtor has already paid the disputed debts.[204]

To the extent a state has not expressly adopted either the majority or minority issue preclusion rule, the proposed approach would require federal bankruptcy courts to engage in an *Erie* analysis.[205] The court would have to predict what rule the state's highest court would adopt. Once the federal court makes the requisite prediction, the court would simply apply the predicted rule.

2. Advantages of the issue preclusion approach.

The issue preclusion approach has a number of advantages. To begin with, it is simple to administer. Under the proposed approach, bankruptcy courts need only identify and apply the state's issue preclusion law, a task in which federal courts are already well versed.[206] At least one federal bankruptcy court has proposed a similar approach for determining whether a bona fide dispute exists.[207] Furthermore, the proposed approach is faithful to *Kimbell Foods* and the *Butner* principle. Recall that *Kimbell Foods* compels federal courts engaged in statutory gap filling to adopt state law as the federal rule of decision unless a

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[203] See Part II.B.

[204] See *Byrd*, 357 F3d at 440.

[205] See notes 198–99 and accompanying text.

[206] See, for example, *McAlister v Essex Property Trust*, 504 F Supp 2d 903, 909 (CD Cal 2007) (applying California issue preclusion law); *1443 Chapin Street, LP v PNC Bank, NA*, 810 F Supp 2d 209, 217 n 7 (DDC 2011) (discussing the application of Maryland issue preclusion law).

[207] See *In re Everett*, 178 Bankr 132, 141 (Bankr ND Ohio 1994) (concluding that a judgment was not the subject of a bona fide dispute based in part on the fact that the creditors' judgment was conclusive for purposes of issue preclusion).

uniform national rule would vindicate a federal interest.[208] The *Butner* principle requires federal bankruptcy courts to respect nonbankruptcy entitlements created by state law.[209] By adopting state issue preclusion law as the federal rule of decision, this approach satisfies the requirements of both *Kimbell Foods* and *Butner*. Additionally, the issue preclusion approach is more faithful to the full faith and credit statute.[210] By adopting state issue preclusion law, federal courts give the same effect—according the same full faith and credit—to state court judgments that state courts would accord their own judgments.

Finally, the issue preclusion approach retains features of both *Marciano* and *Byrd* to some extent. In some states, where judgments are not rendered nonfinal by an appeal, the appeal of an unstayed state court judgment, by itself, will *never* create a bona fide dispute. This is consistent with the Ninth Circuit's view in *Marciano*. In other states, where judgments are rendered nonfinal by an appeal, the appeal of an unstayed state court judgment can create a bona fide dispute. This is consistent with the Fourth Circuit's view in *Byrd*. The issue preclusion approach therefore reconciles *Marciano* and *Byrd*.

3. Objections to the issue preclusion approach.

The Fourth Circuit and Ikuta both anticipated and rejected the issue preclusion approach. The Fourth Circuit explained in *Byrd*:

> According to the district court, whether [the creditor's] unstayed state court judgments created a bona fide dispute depended on the preclusive effect given to [each] judgment under the law of the forum in which the judgment was rendered. In other words, the central issue was whether, under Maryland law, [the creditor's] unstayed state court judgments were final for purposes of res judicata.[211]

Recall that one of the elements of issue preclusion is that "the issue sought to be precluded must be the same as that involved

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208 See Part III.A.1.

209 See Part III.A.1.

210 See Part III.B.2.

211 *Byrd*, 357 F3d at 440 (quotation marks omitted).

in the prior litigation."[212] The Fourth Circuit and Ikuta argued that the determination that a bona fide dispute exists does not satisfy the "same issue" element. That is, they contended that a federal court's determination that a bona fide dispute exists is different than the state court's ruling on the merits of the case.[213] As Ikuta stated in her dissent, "[T]he question whether a determination is *subject to* a genuine dispute is separate from determining the merits of that dispute."[214] Under this reasoning, a state court's ruling on the merits of a creditor's claim is entirely separate from a federal court's determination that a bona fide dispute exists regarding the claim. If the federal bankruptcy court is not relitigating the same issue decided by the state court, then the state court judgment has no preclusive effect on the bankruptcy court. As the Fourth Circuit concluded, "[B]y inquiring into the genuineness of Byrd's appeals, the bankruptcy court was not relitigating Byrd's liability in violation of settled rules of res judicata."[215]

There are three problems with this objection. First, the objection assumes that a federal bankruptcy court—in determining that a bona fide dispute exists—does not relitigate the same issue decided by the state court. There is a clear counterexample to this assumption: summary judgment. When a state trial court grants summary judgment in favor of a set of plaintiffs, the court necessarily finds that no genuine issue of material fact exists.[216] A federal bankruptcy court's finding that a bona fide dispute exists regarding a factual matter would plainly contradict the state trial court's finding that no such dispute exists for purposes of summary judgment.[217] In this type of case, the determination that a bona fide dispute exists addresses the exact

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[212] *H-D Michigan, Inc*, 496 F3d at 760 (quotation marks and citations omitted). See also Part III.B.1.

[213] See *Byrd*, 357 F3d at 440–41; *Marciano*, 708 F3d at 1133 (Ikuta dissenting).

[214] *Marciano*, 708 F3d at 1133 (Ikuta dissenting).

[215] *Byrd*, 357 F3d at 440–41.

[216] See *Biancalana v T.D. Service Co*, 300 P3d 518, 521 (Cal 2013) ("A motion for summary judgment is properly granted if all the papers submitted show that there is no triable issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.") (quotation marks omitted); *Carter v Aramark Sports and Entertainment Services, Inc*, 835 A2d 262, 270 (Md Ct Spec App 2003) (noting that the Maryland Rules of Civil Procedure provide that "[t]he court shall enter judgment in favor of or against the moving party if the motion and response show that there is no genuine dispute as to any material fact and that the party in whose favor judgment is entered is entitled to judgment as a matter of law").

[217] See Part I.D.2.

same issue decided by the state trial court: the existence of an objective dispute of fact.

Second, and more problematically, the objection would allow nearly *every* unsuccessful defendant to claim that a genuine dispute exists. If the determination that a bona fide dispute exists is truly separate from the issues decided by the state court, then nothing prevents the debtor from alleging a bona fide dispute at any stage of the litigation, even after the judgment is final. Under the assumption that sameness is lacking, a debtor would be permitted to allege that a bona fide dispute exists even when the debtor has not taken an appeal or after the debtor has exhausted the appeals process.

Finally, the Supreme Court generally prohibits federal bankruptcy courts from inquiring into the validity of underlying state court judgments. In *Heiser v Woodruff*,[218] a creditor sought to enforce a state court judgment against a bankrupt debtor, and the trustee sought to set aside the judgment on the ground that it was fraudulently obtained.[219] The Court concluded:

> Undoubtedly, since the Bankruptcy Act authorizes a proof of claim based on a judgment, such a proof may be assailed in the bankruptcy court on the ground that the purported judgment is not a judgment .... But it is quite another matter to say that the bankruptcy court may reexamine the issues determined by the judgment itself. It has, from an early date, been held to the contrary.[220]

In short, the determination that a bona fide dispute exists concerns the same issues decided by the state court. Accordingly, such a determination satisfies the "same issue" element of issue preclusion.

D. Applying the Issue Preclusion Approach to *Byrd* and *Marciano*

This Section reconsiders *Byrd* and *Marciano* in light of the issue preclusion approach.

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[218] 327 US 726 (1946).

[219] Id at 728–29.

[220] Id at 736.

1. *Byrd* reconsidered.

Under the issue preclusion approach, the first step is to look to the state court's issue preclusion law. In *Byrd*, a Maryland state court issued the underlying judgment, so a court must look to Maryland's issue preclusion law. Maryland follows the majority approach, treating judgments as final during the pendency of an appeal for the purposes of issue preclusion.[221] However, Maryland only recently adopted the majority rule. In 2004, the same year the Fourth Circuit decided *Byrd*, the Maryland Court of Special Appeals adopted the majority rule in *Campbell v Lake Hallowell Homeowners Association*.[222]

Since Maryland had not yet formally adopted this majority rule when *Byrd* was decided, the Fourth Circuit did not run afoul of the proposed approach. However, if the Fourth Circuit was facing the same set of facts as *Byrd* after 2004, the issue preclusion approach would require the court to apply the majority rule as adopted in *Campbell*. Under the majority rule, the appeal of a judgment does not render it nonfinal for purposes of issue preclusion. Therefore, the appeal of the state court judgment in *Byrd* would not create a bona fide dispute under § 303.

2. *Marciano* reconsidered.

As in the previous case, the first step is to look to the state court's issue preclusion rules. In *Marciano*, a California state court issued the underlying judgment, so a court would need to look to California's issue preclusion law. California is one of the few states that follows the minority rule holding that an appeal renders a judgment nonfinal for purposes of issue preclusion. Under California law, "a judgment is not final for purposes of applying the doctrine[ ] of . . . issue preclusion."[223]

Under state law, the debtor's appeal of the state court judgment rendered the judgment nonfinal for purposes of issue preclusion. The judgment therefore lost any preclusive effect. As

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221 See *In re Day*, 409 Bankr 337, 342 (Bankr D Md 2009) ("A Maryland judgment is final for purposes of collateral estoppel, even when an appeal from the judgment is pending.").

222 852 A2d 1029, 1041 (Md Ct Spec App 2004) ("[T]he pendency of an appeal does not affect the finality of a judgment for res judicata purposes."). See also *1443 Chapin Street, LP*, 810 F Supp 2d at 217 n 7 (citing *Campbell*'s adoption of the majority rule concerning the effect of an appeal for purposes of issue preclusion).

223 *Boblitt v Boblitt*, 118 Cal Rptr 3d 788, 791 (Cal App 2010). See also *Ferraro*, 75 Cal Rptr 3d at 38 ("[W]hile an appeal is pending or, though no appeal has yet been taken, the time for appeal has not expired, the judgment is not conclusive.").

a result, under the issue preclusion approach, and contrary to the finding in *Marciano*,[224] the appeal of the judgment could create a bona fide dispute within the meaning of § 303. However, the appeal would not *automatically* create such a dispute. As Ikuta suggested in her dissent, the determination as to the existence of a bona fide dispute would require a case-specific analysis.[225]

CONCLUSION

This Comment examined whether the appeal of an unstayed state court judgment can create a bona fide dispute for purposes of involuntary bankruptcy proceedings. The indefinite language of § 303, in conjunction with a sparse legislative record, renders the term "bona fide dispute" ambiguous. Furthermore, neither the predominant judicial test for determining the existence of a bona fide dispute—the objective-basis standard—nor the purposes of involuntary bankruptcy decisively resolve the matter. The issue also raises significant federalism concerns and creates potential conflicts between federal bankruptcy courts and state trial courts. The adoption of the issue preclusion approach proposed here, which requires bankruptcy courts to determine whether a state court judgment is final for purposes of issue preclusion, provides a solution to the existing circuit split. The issue preclusion approach avoids potential federalism concerns by requiring federal bankruptcy courts to adopt state issue preclusion law as the federal rule of decision. Moreover, the proposed approach gives content to *Marciano* and *Byrd*. In some states, where an appeal does not render a judgment nonfinal for purposes of issue preclusion, the appeal of an unstayed state court judgment, by itself, will never create a bona fide dispute for purposes of § 303, as *Marciano* held. In other states, where an appeal renders a judgment nonfinal for purposes of issue preclusion, the appeal of an unstayed state court judgment may create a bona fide dispute, as *Byrd* held. The issue preclusion approach provides the best of both worlds.

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[224] See *Marciano*, 708 F3d at 1128.

[225] See id at 1134–35 (Ikuta dissenting).