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Bankruptcy in the Nonprofit Context

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I. BANKRUPTCY RELIEF FOR NONPROFITS

Bankruptcy offers non-profit enterprises many of the same forms of relief that for-profit enterprises seek: to halt pending litigation or enable aggregating multiple litigation into one venue, to stay collection efforts by creditors, to obtain breathing room within which to attempt to reorganize debts, or to enable and control an orderly liquidation of assets. While there can be many similarities between the bankruptcy case of a nonprofit and the bankruptcy case of a for-profit enterprise, there are issues that are specific to nonprofit enterprises in bankruptcy. This article provides a high-level overview of certain generalities of bankruptcy then outlines some of the issues specific to bankruptcy cases for nonprofits.

A. CAN WE FILE FOR BANKRUPTCY: ELIGIBILITY REQUIREMENTS

Section 109(a) of the Bankruptcy Code[1] contains the eligibility requirements a debtor must satisfy to file a petition under any chapter of the Bankruptcy Code. 11 U.S.C. 109(a). A debtor must be a "person," defined in the Bankruptcy Code as an individual, partnership or corporation, and must reside or have a domicile, a place of business or property in the United States. The term "corporation," is includes: (i) an association having a power or privilege that a private corporation possesses; (ii) an unincorporated company or association; or (iii) a business trust. As long as it is organized under applicable state law as one of those types of entities, almost any nonprofit organized in the United States could qualify to file a bankruptcy petition under either Chapter 7 or Chapter 11.

B. NONPROFITS PROBABLY CANNOT BE PUT IN INVOLUNTARY BANKRUPTCY

One of the more powerful, although infrequently used, tools that creditors have by which to bring recalcitrant debtors to bear comes in the form of involuntary bankruptcy. Section 303 provides in relevant part that creditors may commence an involuntary bankruptcy case ". . . only under Chapter 7 or 11 of this

[1] The constitutionally authorized uniform laws of bankruptcy can be found in title 11 of the United States Code, which is generally referred to in the bankruptcy community as the "Bankruptcy Code."

title, and only against a person, except a farmer, family farmer or a corporation that is not a moneyed, business or commercial corporation . . . ."[2] Although the Bankruptcy Code does not expressly define the phrase "corporation that is not a moneyed, business or commercial corporation," the most straight-forward interpretation of that phrase is that it precludes creditors from filing an involuntary petition against a nonprofit.[3]

As a result of Section 303 not expressly prohibiting creditors from filing an involuntary petition against a nonprofit, several standards have developed in the caselaw for determining whether a particular alleged debtor is "not a moneyed, business or commercial corporation."[4] Some courts apply a "classification" test, which defaults to relying on the debtor's registration with the state as a nonprofit being sufficient by itself to determine that the debtor is "a corporation that is not a moneyed, business or commercial corporation."[5] Other courts, apparently more inclined to prefer murkier water, apply a more comprehensive "corporate activity" test, under which an entity's classification pursuant to state law combined with the nature of its activities will both be considered.[6]

[2] 11 U.S.C. § 303(a).

[3] The legislative history of Section 303 provides that "schools, churches, charitable organizations and foundations are protected from involuntary bankruptcy." *See* H.R. Rep. No. 95-595, at 321 (1977); S. Rep. No. 95-989, at 33 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6277, 6278, 5787, 5819.

[4] For further discussion, *see* James Lockhart, *What Constitutes "Moneyed, Business, or Commercial Corporation" Subject to Involuntary Bankruptcy or Reorganization Upon Creditors' Petition Under 11 U.S.C.A. § 303(a) and Predecessor Statutes*, 24 A.L.R. Fed. 2d 397 (2007). *See also In re Dairy Mktg. Ass'n of Ft. Wayne*, 8 F.2d 626, 628 (D. Ind. 1925) (holding that an involuntary petition could not be filed against a co-operative dairy market association because it was not a moneyed, business or commercial corporation, finding that the "character of a corporation or association must be determined from its articles of incorporation and the statute authorizing its formation."); *In re Weeks Poultry Cmty., Inc.*, 51 F.2d 122 (D.C. Cal. 1931) (holding that a co-operative marketing association was not a moneyed, business or commercial corporation pursuant to the reasoning articulated in *Dairy Mktg. Ass'n*.).

[5] *Id*. at note 8.

[6] *Id*.

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