CORPORATE BANKRUPTCY FILINGS MUST BE AUTHORIZED

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For better or for worse, bankruptcy filings have become almost commonplace. In particular, the Chapter 11 petition has become an increasingly valuable and widely accepted tool for small, closely-held corporations, as well as large, publicly-traded companies to restructure their debt and/or reorganize their operations and financial affairs.

The Bankruptcy Code authorizes a "person" that resides or has a domicile, a place of business, or property in the United States, or a municipality, to be a "debtor", and thus to file for bankruptcy protection. A "person" as defined by the Bankruptcy Code includes an individual, partnership, or corporation.

Although a corporation may file a petition for relief under the Bankruptcy Code, corporate directors, shareholders, creditors, and other interested parties need to be mindful that such a filing must be properly authorized. Absent requisite authorization, a corporate bankruptcy petition can be dismissed and the significant protections and benefits otherwise afforded the corporate debtor under the Bankruptcy Code lost.

In order for a corporation to initiate voluntary bankruptcy proceedings, a valid resolution of the board of directors must first be adopted. In the absence of a valid resolution of the board, voluntary bankruptcy proceedings are subject to dismissal.

The initiation of bankruptcy proceedings, like the run of other corporate activities, is left to the corporation itself, *i.e.*, to those who have the power of management, and the determination of who has the power of management is governed by state law. The law of New Jersey is in accord with the general rule that the power to file a voluntary bankruptcy petition on behalf of a corporation rests with the board of directors. Thus, a valid, duly adopted resolution of the board is necessary in order to initiate and maintain voluntary proceedings in bankruptcy for a corporate debtor.

Absent some contrary provision in the corporate charter or by-laws, a majority of the directors is necessary to constitute a quorum to transact business. Only when such a quorum is convened following proper notice to all directors of the time, place and object of a meeting, can a majority

thereof do any act within the power of the body. Moreover, a director must be physically present to act at a director's meeting; he or she cannot act by proxy. Even a deadlock over the filing of a voluntary bankruptcy petition does not justify commencement of such a proceeding absent proper corporate authority and a valid resolution.

It is noteworthy that shareholders in their capacity as shareholders have no authority to initiate voluntary bankruptcy proceedings for a corporation since they do not have the power of management. This is so even if the directors have breached their trust, caused the corporation to perform acts confiscatory of shareholders interests, or have refused to invoke actions to protect the corporation.

In In re Joseph Feld & Co., 38 F. Supp. 506 (D.N.J. 1947), the New Jersey District Court dismissed a voluntary bankruptcy proceeding by reason of the irregularity of a meeting of directors and the consequent invalidity of the resolution authorizing the institution of the bankruptcy case. In that case, the Court pointed out that under New Jersey corporation law, the business management of a corporation is committed to the directors "who may act only as a body lawfully assembled".

A creditor or any party in interest may request dismissal of a case commenced under the Bankruptcy Code for "cause". Such "cause" may include lack of jurisdiction. In this regard, the Bankruptcy Court may inquire into the internal affairs of a corporate debtor to determine the validity of a resolution purportedly authorizing the filing of a voluntary bankruptcy petition, and to determine whether it has jurisdiction over a particular case. In Joseph Feld & Co., the Court made it clear that proper corporate authority in the filing of a voluntary bankruptcy petition and, in particular, the existence of an invalid corporate resolution having its origin in an illegal meeting of directors, is jurisdictional, and that a court should not assume jurisdiction of a voluntary bankruptcy proceeding "based on an invalid resolution which had its origin in an illegal meeting of Directors". Indeed, it is clear that a court must dismiss a voluntary bankruptcy petition filed by those not having authority to do so under state law for jurisdictional reasons.

Similarly, in In re Giggles Restaurant, Inc., 103 B.R. 549 (Bankr. D.N.J. 1989), the New Jersey Bankruptcy Court found itself without jurisdiction over a voluntary Chapter 11 proceeding because the corporate resolution authorizing the filing was invalid. Consequently, the Court had no alternative

but to dismiss the bankruptcy proceedings on a motion by the debtor's landlord, thus resulting in a loss to the debtor of those critical rights and benefits available to a debtor under the Bankruptcy Code.

The decisional law is clear -- the power to file a voluntary bankruptcy petition on behalf of a corporation rests solely with the board of directors. Absent a valid resolution of a duly assembled board, a voluntary petition under any chapter of the Bankruptcy Code may be dismissed by the court on its own motion or upon application of any interested party. Accordingly, due care must be taken by any corporate entity contemplating the commencement of voluntary bankruptcy proceedings to ensure that the petition that is filed has been properly authorized by the board of directors in accordance with state law. Conversely, a creditor, shareholder or other interested party who may benefit from dismissal of a bankruptcy petition filed by a corporate entity should consider, and in fact confirm, whether or not such petition has been properly authorized pursuant to a duly adopted board resolution.