UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

IN RE:

QUALIS CORPORATION CASE NO. 93-60525

Debtor

APPEARANCES:

LEE WOODARD, ESQ.
Attorney for Petitioning Creditors
One Lincoln Center
Syracuse, New York l3202

HAROLD P. GOLDBERG, ESQ.
Attorney for Debtor
l408 West Genesee Street
Syracuse, New York l3202

STEPHEN D. GERLING, U.S. Bankruptcy Judge

MEMORANDUM-DECISION, FINDINGS OF FACT,
CONCLUSIONS OF LAW AND ORDER

The instant Involuntary Petition was filed with the Clerk of this Court on February 22, l993. Also on February 23, l993 this Court granted an Order to Show Cause directing Qualis Corporation ("Qualis") to show cause why it should not be preliminarily enjoined from transferring and/or encumbering any of its assets pending the entry of an order for relief pursuant to Chapter 7 of the Bankruptcy Code (ll U.S.C. §§101-1330)("Code").

On the return date of the Order to Show Cause, Qualis and petitioning creditors entered into a Stipulated Order dated March ll, l993 which inter alia extended Qualis' time to answer the Involuntary Petition until after an examination of the Debtor pursuant to Federal Rule of Bankruptcy Procedure ("Fed.R.Bankr.P.") 2004 had been completed. Qualis' answer to the Involuntary Petition was ultimately filed with the Court on May l0, l993 after a further stipulated extension of time between the parties.

A trial on the Involuntary Petition was held before the Court on August 25, l993 and upon the completion of the trial the parties requested an opportunity to engage in further settlement discussions. On November 29, l993, having heard nothing further from the parties, the Court requested memoranda of law to be filed by January 3, l994. Thereafter, only Qualis filed a memorandum

of law and this contested matter was submitted for decision.

JURISDICTIONAL STATEMENT

The Court has core jurisdiction of this involuntary petition pursuant to 28 U.S.C. §§1334(b) and l57(a), (b)(l) and (2)(0).

FACTS

Qualis was a general contractor with a principal place of business at 6399 E. Molloy Road, East Syracuse, New York l3057. Prior to the filing of the Involuntary Petition, Qualis had been engaged in numerous construction projects throughout the upstate New York area.

On or about November 5, l992, Qualis entered into a bulk transfer of its assets pursuant to §6-l04 of the New York Uniform Commercial Code ("NYUCC"). The transfer was made to Woodwise Case, Inc. ("Woodwise"). Included in the list of creditors apparently notified of the bulk transfer were the three petitioning creditors herein, Fortunato Electric Service of Central New York ("Fortunato"), Raulli & Sons, Inc. ("Raulli") and Taylor Rental Center ("Taylor").

On February 22, l993, the three petitioning creditors filed the instant involuntary petition, alleging that Qualis owed them in the aggregate a total of $2l,864.07. They further alleged that Qualis was not paying its debts as they became due. (See Involuntary Petition filed February 22, l993). Qualis' Answer to the Petition filed May 10, l993, as indicated, simply denies the allegations of the Petition.

ARGUMENTS

Neither Qualis nor the petitioning creditors appear to dispute the existence of pre-petition debt due and owing from Qualis to the three creditors, however, Qualis contends that only the debt owed to Raulli qualified it to file an involuntary petition pursuant to Code §303(b)(l). With regard to Taylor, Qualis contends that it agreed to look to Woodwise for the payment of the debt

formerly owed by Qualis, thereby releasing Qualis from any liability by virtue of a novation . Qualis also asserts that in view of the novation, Taylor's participation as a petitioning creditor was motivated by bad faith.

As to Fortunato, Qualis argues that its claim is contingent as to liability since Fortunato agreed that it would be paid as Qualis' sub-contractor only upon payment to Qualis by the owner of the projects located at a Syracuse area mall. Qualis contends that it has not and will not be paid on the project at the mall and, therefore, it owed nothing to Fortunato at the time the Involuntary Petition was filed.

Presumably the petitioning creditors, at least Fortunato and Taylor, dispute the contentions of Qualis and contend that as of the date of the Involuntary Petition, the debts due them were neither contingent nor subject to bona fide dispute.

Finally, Qualis argues that this Court should exercise its discretion pursuant to Code §305 and abstain from hearing the matter as an involuntary Chapter 7 case, even if the petitioning creditors prove compliance with Code §303(b). Qualis asserts in support of abstention the fact that as the testimony indicated, all of its assets were transferred in bulk, well beyond the ninety day preference period, and the Alleged Debtor has ceased doing business. At the conclusion of the trial, Qualis moved to dismiss the Involuntary Petition and the Court reserved decision.

DISCUSSION

Code §303(b) governs the filing of an involuntary bankruptcy petition and requires that where the alleged debtor has twelve or more creditors, the petition must be executed by at least three creditors who hold claims against the alleged debtor which claims are neither "contingent as to liability or the subject of a bona fide dispute" as of the date of the petition.

In the case sub judice there does not appear to be any dispute that Raulli meets the criteria of Code §303(b). Likewise there is no dispute that Qualis had twelve or more creditors at the time the involuntary petition was filed, thus requiring that there be at least three petitioning creditors.

Considering first Fortunato's claim arising out of two construction projects undertaken by Qualis at a Syracuse mall, the alleged debtor asserts that Fortunato's claim is contingent as to liability because it was agreed between Qualis and Fortunato that the latter would be paid only after payment to Qualis by the owner.

On cross-examination by Qualis' attorney, Fortunato's president testified that he was aware that the Syracuse mall owner had not paid Qualis for the work performed. He disputed, however, Qualis' contention that payment to Fortunato was contingent upon payment to Qualis by the mall owner.

Qualis apparently equates "contingent as to liability" with contingent as to payment, since there does not appear to be any dispute that Qualis was liable to Fortunato for work actually performed by Fortunato.

Qualis relies upon In re Elsub Corp., 70 B.R. 797 (Bankr. D.N.J. l987) for its contention that contingent as to liability is synonymous with contingent as to payment; however, the Court believes its reliance is misplaced. In that case, the bankruptcy court actually concluded that generally speaking, claims contingent as to liability are claims which exist under guaranty/surety situations or tort claims that remain unliquidated pre-petition, in other words, claims that do not accrue until the happening of a future event. Id. at page 808.

The Elsub court also observed that the Bankruptcy Reform Act of l978 broadened the category of creditors who were eligible to file involuntary petitions by eliminating the requirement that a petitioning creditor's claim be provable. As a result, creditors holding "unmatured, disputed and unliquidated claims are not specifically barred from being petitioning creditors." Id. at 8097. See also In re First Energy Leasing Corp., 38 B.R. 577, 58l (Bankr. E.D.N.Y. l984); contra In re Skye Marketing Corp., ll B.R. 89l, 899 (Bankr. E.D.N.Y. l98l).

Thus, the Court concludes that Fortunato's claim was not contingent as to liability, but arguably unmatured as of the date of the petition and, therefore, Fortunato qualified as a petitioning creditor pursuant to Code §303(b)(l).

Turning to the status of Taylor, Qualis asserts that a novation

occurred pre-petition when Taylor agreed to look to Woodwise for the payment of its claim against Qualis, thus stripping Taylor of any right it had to be a petitioning creditor in this case.

Qualis relies upon an undated and unsigned promissory note ("Note") received in evidence by stipulation, which generally purports to obligate Woodwise to pay five judgment creditors of Qualis one-half of their judgment balances in installments commencing on July l, l993. At trial John St. Dennis ("St.Dennis"), a representative of Taylor, testified without contradiction that Woodwise has defaulted on the payments due under the Note.[1]

The Note contains default provisions which entitled the various judgment creditors, including Taylor, to an immediate payment of the amounts provided for in the Note upon Woodwise's default, with interest to accrue from the date of acceleration. In the alternative, the judgment creditors may sue Woodwise.

Qualis contends that the Note, executed only by Woodwise, constitutes a novation of the debt formerly due from Qualis to Taylor and that Taylor agreed to look solely to Woodwise for payment.

A novation is said to require (l) a previous valid obligation; (2) agreement of all parties to the new contract; (3) extinguishment of the old contract; and (4) a valid new contract. See 22 N.Y.Jur.2d. Contracts §40l. A novation may only be created when all parties concerned agree to the new transaction. Id. §402. A creditor must consent to the substitution of one debtor for another and must accept the new debtor in place of the old debtor to bring about a novation. Whereas, mere knowledge by the creditor of the existence of the assumption of the debtor's obligation by a third party does not constitute consent which will extinguish the original debt and release the original debtor.

However, the creditor may by his or her conduct indicate their consent to the novation. Id. §406. Finally, where a new debtor is substituted for the original debtor, it must be apparent the creditor has unconditionally released the original debtor. Id. §409.

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[1] While the Note introduced into evidence by Qualis is unsigned and undated, it was received by stipulation of the parties and will be treated as having been fully executed.

At the trial of this Involuntary Petition, St. Dennis testified that he was aware of an agreement between Taylor, Woodwise and Qualis regarding payment of the Qualis debt due Taylor. He acknowledged that the Note constituted the agreement and that in fact a payment had been made by Woodwise to Taylor before Woodwise defaulted on the Note. A review of the terms of the Note leads to the conclusion that upon default in payment the judgment creditors, including Taylor, would proceed against Woodwise not against Qualis. Thus, it appears that by executing the Note and absent any testimony to the contrary, Taylor consented to a release of Qualis and the substitution of Woodwise as the sole obligor on its judgment. See Callanan Indus., Inc. v. Micheli Contracting Corp., l24 A.D.2d 960, 508 N.Y.S.2d 7ll (3d Dep't 1986).

The Court reaches the conclusion, therefore, that the petitioning creditors have failed to meet the requirements of Code §303(b)(l) which under the circumstances here requires "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", in order to file an involuntary petition.

Having reached the foregoing conclusion, the Court need not consider the alternative argument of Qualis that the Court should abstain from entertaining this involuntary petition pursuant to Code §305 and 28 U.S.C. §1334(c). The Court does note, however, that from the testimony and documentary evidence introduced at trial, Qualis engaged in a so-called bulk sale of its assets on or about November 5, l992, more than ninety days prior to the filing of the Involuntary Petition, which left Qualis out of business with a minimal amount of cash being held by its attorney and some accounts receivable arguably subject to the lien of a secured creditor.

It would thus seem that the timing of the Involuntary Petition was inopportune at best and it would not appear to benefit the petitioning creditors nor any of Qualis' creditors at this point in time.

Accordingly, the motion of Qualis to dismiss the Involuntary Petition filed herein on February 22, l993 must be granted and the Involuntary Petition is dismissed.

IT IS SO ORDERED.

Dated at Utica, New York

this day of February, l994

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STEPHEN D. GERLING
U.S. Bankruptcy Judge