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The New Normal for Distressed Energy Companies

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These claims can take a variety of forms and, in Texas, are typified by three primary causes of action: (1) suit on sworn account, (2) breach of contract and (3) quantum meruit. In addition, especially aggressive creditors, under the right circumstances, can seek to force a debtor into involuntary bankruptcy under Section 303 of the U.S. Bankruptcy Code (the "Code").

This article is intended to be the first in a series of topics relevant to distressed energy companies in the current economic climate. The following focuses on debt collection actions brought under Rule 185 of the Texas Rules of Civil Procedure, frequently called a "suit on sworn account." This type of claim may not be as well-known as a typical breach of contract or an equitable "quantum meruit" claim. However, what is significant about these types of claims is not only the higher pleading standard required to both file and answer these claims, but also the expedited litigation process for such claims. The following provides a brief overview of the law, as well as practical considerations.

B. Overview of Rule 185 Claims

Rule 185 is a procedural tool that limits the evidence necessary to establish a prima facie right to recovery on certain types of accounts. *Williams v. Unifund CCR Partners Assignee of Citibank*, 264 S.W.3d 231, 234 (Tex. App. — Houston [1st Dist.] 2008, no pet.). However, this procedure is not available for all types of claims. Specifically, Rule 185 applies only to (1) transactions between persons, (2) where there is a sale on one side and a purchase on the other, (3) whereby title to personal property has passed from one person to the other, and (4) where the relation of the debtor and creditor is created by a general course of dealing. *Id*.

a. Plaintiff's Elements

To prevail on a suit on sworn account, a plaintiff must show three elements: (1) that there was a sale and delivery of the merchandise or performance of the services; (2) that the amount of the account is just (i.e., prices were charged in accordance with the agreement or, in the absence of an agreement, are usual, customary and reasonable prices for the merchandise or services); and (3) that the amount is unpaid. *Worley w. Burler*, 809 S.W.2d 242, 245 (Tex. App. — Corpus Christi 1990, no writ). Further, a petition for suit on sworn account must contain a systematic, itemized statement of the goods or services sold; reveal offsets made to the account; and be supported by an affidavit stating that the claim is within the affiant's knowledge, and that it is "just and true." *Powers v. Adams*, 2 S.W.3d 496, 498 (Tex. App. — Houston [14th Dist.] 1999, no pet.). General statements without a description of specific items are insufficient. *Mega Builders Inc., v. American Door Prods*., (Tex. App. — Houston [1st Dist.] 2013, no pet.) (mem. op.). In addition, the account must include specific facts regarding how the figures were established. *Dibco Underground, Inc. v. JCF Bridge & Concrete, Inc.* (Tex. App. — Austin 2010, no pet.) (mem. op.).

b. Answering a Claim

As a general rule, defendants involved in Texas litigation will typically file a general denial under Rule 92 of the Texas Rules of Civil Procedure. However, a defendant challenging a suit on sworn account must strictly comply with the requirements of Rule 185, "or he will not be permitted to dispute the receipt of the services or the correctness of the charges." *Panditi v. Apostle,* 180 S.W.3d 924, 927 (Tex. App. — Dallas 2006, no pet.); see also *Vance v. Holloway*, 689 S.W.2d 403, 404 (Tex. 1985) (per curiam). Specifically, Rule 185 requires a defendant to "comply with the rules of pleading" and "timely file a written denial, under oath," or else the defendant "shall not be permitted to deny the claim, or any item therein." Tex. R. Civ. P. 185; *Panditi*, 180 S.W.3d at 927 (Rule 185 requires a sworn denial to be written and verified by affidavit). This "verified denial" is required by Rule 93 of the Texas Rules of Civil Procedure. See, e.g., *Huddleston v. Case Power & Equip. Co.*, 748 S.W.2d 102, 103 (Tex. App. — Dallas 1988, no writ); see also Tex. R. Civ. P. 93(10) ("A pleading setting up any of the following matters, unless the truth of such matters appear of record, shall be verified by affidavit[:] A denial of an account which is the foundation of the plaintiff's action . . . .").

c. Consequences of Failing to File a Proper Verified Denial

Importantly, a verified denial must be included in a defendant's answer; a sworn denial made in a response to a summary judgment motion is too late and does not satisfy Rule 185. See *Cooper v. Scott Irrigation Constr., Inc*., 838 S.W.2d 743, 746 (Tex. App. — El Paso 1992, no writ);

see also *Rush v. Montgomery Ward*, 757 S.W.2d 521, 523 (Tex. App. — Houston [14th Dist.] 1988, writ denied). If the defendant fails to file a verified denial to the sworn account, the sworn account is received as prima facie evidence of the debt, and the plaintiff, as summary judgment movant, is entitled to summary judgment on the pleadings. *Nguyen v. Short, How, Frels & Heitz, P.C.*, 108 S.W.3d 558, 562; see also *Livingston Ford Mercury, Inc. v. Haley*, 997 S.W.2d 425, 430 (Tex. App. — Beaumont 1999, no pet.) (holding that, when plaintiff files a proper sworn account petition but defendant does not comply with Rule 185, the petition will support summary judgment and "additional proof of the accuracy of the account is unnecessary"). In other words, a defendant's noncompliance with Rule 185 conclusively establishes that there is no defense to the suit on the sworn account. *Nguyen,* 108 S.W.3d at 562; see *Whiteside v. Ford Motor Credit Corp.*, 220 S.W.3d 191, 194 (Tex. App. — Dallas 2007, no pet.) ("When the defendant fails to file a sworn denial and the trial court enters summary judgment on a sworn account, appellate review is limited because the defendant will not be allowed to dispute the plaintiff's claim.").

C. Practical Considerations

a. When is a general denial sufficient?

In the event that a plaintiff's suit on a sworn account was not properly pleaded pursuant to Rule 185, a defendant is not required to file a sworn denial — rather, a general denial will suffice. *Panditi*, 180 S.W.3d at 927; *Tex. Dep't of Corrs. v. Sisters of St. Francis of St. Jude Hosp.*, 753 S.W.2d 523, 524 (Tex. App. — Houston [1st Dist.] 1988, no writ).

b. How are facts put at issue?

As mentioned above, a verified denial should place one or more of the facts alleged in the petition on sworn account at issue. As a practical matter, a defendant can do so by providing, for example, a verified denial that attests to one or more of the following facts:

1. That the alleged account(s) do not, in fact, exist and the debtor does not have knowledge of those accounts;
2. That the amounts alleged are not due and owing as alleged in the petition in view of applicable payment terms and conditions (e.g., purchase orders, master agreements, nonreceipt of conforming goods or services, or similar deficiencies);
3. That all setoffs have not been appropriately applied;
4. That interest or similar charges have not been properly calculated; and/or
5. That the overall amounts alleged have not been properly calculated.

c. What is the timing for judgment on suits on sworn accounts?

Those generally familiar with the litigation process typically associate claims brought in Texas district courts with a 12- to 18-month trial horizon. However, the time frame associated with a suit brought under Rule 185 can be far more aggressive. In the absence of a timely filed verified denial that puts one or more of the alleged facts at issue, a plaintiff can move for a summary judgment on the verified petition without discovery. Under Rule 99(b) of the Texas Rules of Civil Procedure, a defendant's answer is due the first Monday after the expiration of 20 days of service of process. Also, under Rule 21a, a summary judgment motion may be heard on 21 days' prior written notice. Thus, a plaintiff can potentially obtain a judgment in less than two months after service of process. A short time later, this judgment will become final and will allow for recovery against a defendant, which can include seizure of assets to satisfy a judgment. Accordingly, these types of claims should be treated seriously even if the amount in dispute may be relatively low.

d. How can involuntary bankruptcy be avoided?

Another important consideration in managing these types of claims is avoiding a situation whereby a company can be forced into bankruptcy. Specifically, under Section 303 of the Code, a group of creditors can force a debtor into involuntary bankruptcy. 11 U.S.C. § 303 (2016). Where a debtor has 12 or more creditors, an involuntary bankruptcy petition requires (a) three or more creditors, each of whose claims are not contingent as to liability or subject to a bona fide dispute as to either liability or amount to file the petition, and (b) that those qualifying claims aggregate at least $10,000 more than the value of any lien on the debtor's property securing claims held by the holders of such claims. *Id*. In contrast, if the company has fewer than 12 creditors, excluding any employees and insiders of such person and any transferee of a transfer that is voidable under the Code, an involuntary petition can be filed by one or more of such creditors whose claims aggregate at least $10,000 of such claims. *Id*.

If the debtor timely objects to the filing of a petition for involuntary bankruptcy, in order for the debtor to be placed in bankruptcy, the debtor also must (1) generally not be paying its debts as they become due (unless those debts are subject to a bona fide dispute as to liability or amount), or (2) have had a custodian appointed within the past 120 days to take possession or control of substantially all of its assets. *Id.*

As a practical matter, however, the potential liability to a creditor for costs, attorney's fees, damages and possibly punitive damages makes involuntary petitions one of the lesser-used creditor tools. Involuntary bankruptcy is most often used when unsecured creditors suspect

fraud on the part of a debtor, or for some other extraordinary reason. Otherwise, creditors will typically pursue collection of their own claims directly, including through litigation. While such a tactic might end up effectively "forcing" a debtor into bankruptcy, it technically would nonetheless be considered voluntary bankruptcy.

Regardless, in order to avoid a situation where a company is forced to defend against an involuntary bankruptcy petition and incurring fees and expenses in doing so, a company should be proactive and strategic in managing vendor claims. These claims should be considered in a company's overall analysis of restructuring strategies, including considerations with respect to whether and when to file for protection (whether under chapter 7 or chapter 11) of the Code, as well as whether the claims present compliance issues under the company's debt instruments and commercial contracts.

*This blog post was originally on AG Speaking Energy.

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