



## **New York Bankruptcy Court Rules that Partial Dispute of Creditor's Claim Results in Disqualification as Petitioning Creditor in Involuntary Bankruptcy Proceeding**

The involuntary bankruptcy petition is a powerful tool for creditors dealing with delinquent debtors. Section 303 of the Bankruptcy Code authorizes three or more creditors to compel a Chapter 7 bankruptcy proceeding. [1] The debtor then has the option to: (i) challenge the filing, (ii) convert the Chapter 7 case to a Chapter 11 restructuring case, or (iii) do nothing, and liquidate in Chapter 7. To be eligible to file an involuntary petition, the creditor's claim must be non-contingent, liquidated and not subject to "*bona fide*" dispute.

Bankruptcy courts remain split as to whether a dispute as to any portion of a claim (even if some portion of the claim remains undisputed) constitutes a *bona fide* dispute as to the amount of the claim sufficient to prohibit the filing of an involuntary petition under 11 U.S.C. § 303(b)(1). In the First, Fifth, and Ninth Circuits, a creditor lacks standing to be a petitioning creditor under 11 U.S.C. §303(b)(1) if any portion of its claim is the subject of a *bona fide* dispute as to liability or amount.

The Second Circuit has not yet ruled on this issue. Recently however, the Honorable Lisa G. Beckerman of the United States Bankruptcy Court for the Southern District of New York in *In re TV Azteca, S.A.B. de C.V., et al*, 2023 WL 8059362 (Bankr. S.D.N.Y. Nov. 20, 2023) ("*TV Azteca*") dismissed certain involuntary petitions holding that *bona fide* disputes as to a portion of the petitioning creditors' claims disqualified those creditors under 11 U.S.C. §303(b)(1).

The debtor, TV Azteca, is a mass media company incorporated in Mexico. In 2017, TV Azteca issued \$400 million in unsecured notes pursuant to an indenture. The indenture and notes were governed by New York law, and provided that any proceeding against TV Azteca arising out of or relating to the indenture or the notes could be instituted in New York state court or in federal court in Manhattan.

TV Azteca defaulted under the indenture and notes by failing to make interest payments. On May 3, 2022, certain beneficial owners of the notes served a notice of acceleration upon TV Azteca and the indenture trustee, declaring the unpaid principal (and premium, if any) and accrued and unpaid interest on all the notes immediately due and payable. On August 5, 2022, the indenture trustee, on behalf of the beneficial owners, also sent TV Azteca a notice of acceleration. On August 8, 2022, the indenture trustee issued an amendment to its notice declaring the unpaid principal, premium, accrued and unpaid interest, and any other amounts owed on the notes and under the indenture immediately due and payable.

On August 26, 2022, the indenture trustee commenced an action for summary judgment in New York County Supreme Court against TV Azteca (and various guarantors under the notes) demanding principal, interest and other sums due, including \$16 million as a redemption premium. TV Azteca disputed liability for the redemption premium, alleging that the premium was not due because there had been no voluntary redemption. On September 23, 2022, TV Azteca and the guarantors filed a notice of removal, and the case was removed to the United States District Court for the Southern District of New York (the "Southern District Action").

[1] One or more creditors can file an involuntary bankruptcy petition if the debtor has less than 12 creditors.

On July 8, 2022, despite the forum-selection clause, TV Azteca filed a complaint against certain holders of the notes in the Ninth Civil Court of the Court of Justice for Mexico City. The Ninth Civil Court issued a preliminary injunction suspending the acceleration notices and prohibited the parties from pursuing any proceeding for the collection and/or payment of the notes. On September 22, 2022, TV Azteca filed a second complaint in the Sixty-Third Civil Court of the Court of Justice of Mexico City alleging that the COVID-19 pandemic was the reason it and the guarantors could not fulfill their obligations under the indenture. The Sixty-Third Civil Court issued an *ex parte* injunction on September 27, 2022.

On March 20, 2023, several note holders filed involuntary petitions for relief pursuant to 11 U.S.C. § 303 against TV Azteca and the guarantors of the notes in the United States Bankruptcy Court for the Southern District of New York (the “Bankruptcy Court”). To ensure that they had the requisite standing to file the involuntary petition, the petitioners claimed only the amounts due for principal and interest under the notes. The debtors moved to dismiss the involuntary petitions on several grounds, including but not limited to, that the involuntary petitions should be dismissed because the petitioning creditors’ claims were subject to *bona fide* dispute with respect to the redemption premium, making the involuntary petitions deficient pursuant to 11 U.S.C. §303(b)(1). However, the debtors conceded liability for the principal and interest of the notes.

Section 303(b)(1) of the Bankruptcy Code authorizes the filing of an involuntary case against a person by filing a petition under chapter 7 or 11 by three or more entities, that hold 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, or an indenture trustee representing such a holder, if such non-contingent, undisputed claims aggregate at least \$18,600 more than the value of any lien on property of the debtor securing such claims held by the holders of such claims.”

Petitioning creditors carry the initial burden of establishing a *prima facie* case that no *bona fide* dispute to their respective claims exists. The Bankruptcy Court found that the petitioners met their initial burden based upon the information included in the involuntary petitions, the supporting declarations filed by each of the creditors, the statement in support of the involuntary petitions, the notes, the indenture, and the acceleration notices. *TV Azteca*, 2023 WL 8059362, at \*5.

Once a *prima facie* case has been established, the burden shifts to the debtor to demonstrate the existence of *bona fide* dispute. The debtors argued that the District Court Action constituted evidence that the creditors’ claims were subject to *bona fide* dispute. Judge Beckerman noted that the issue as to whether a redemption premium was due and owing was “clearly in dispute” since the debtors argued in the District Court Action that they did not owe the redemption premium. *Id.* at \*6. However an issue remained whether the dispute as to a portion of the petitioners’ claims, which were not included in the involuntary petitions, deemed those creditors ineligible to be involuntary petitioners under 11 U.S.C. § 303(b)(1).

Judge Beckerman agreed with the approaches taken in the First, Fifth, and Eleventh Circuits and concluded that the dispute with respect to the redemption premium barred the petitioners from filing the involuntary petitions. The 2005 amendment to Section 303(b) provides that: “any dispute regarding the amount of the petitioning creditors’ claims that arises from the same transaction and is part of the underlying claim renders the claim subject to a *bona fide* dispute.” *Id.* at \*7.

Judge Beckerman declined to adopt the approach taken by now Chief Bankruptcy Judge Martin Glenn, a fellow judge in the Southern District, in *In re Manolo Blahnik USA, Ltd.*, 619 B.R. 81, 98 (Bankr. S.D.N.Y. 2020), which held that the petitioners were not disqualified from filing involuntary petitions even though their claims from one of two invoices were disputed. Judge Beckerman differentiated *TV Azteca* from *Manolo Blahnik* because: (i) the involuntary petitions and the District Court Action arose from the same notes and indentures, (ii) the indenture trustee was seeking recovery of the redemption premium in the District Court Action on behalf of all note holders, and (iii) the involuntary petitioners joined with other note holders and directed the indentured trustee to serve the acceleration notice, including the demand for payment of the redemption premium. *Id.* Lastly, counsel for the petitioners in *TV Azteca* also was counsel to the indenture trustee in the District Court Action, and thus, Judge Beckerman held that if there were an order for relief, she expected that the indenture trustee would file a claim on behalf of all holders seeking the disputed redemption premium. The Court declined to “disregard the District Court Action” brought by the indenture trustee who is a fiduciary acting on behalf of all of the note holders, including the petitioners, where the damages sought included a redemption premium, and thus, granted the motion to dismiss the involuntary petitions. *Id.* at \*8-9.

There is an apparent split within the Second Circuit as reflected by the dueling decisions in *TV Azteca* and *Manolo Blahnik*. It is imperative that potential involuntary petitioning creditors properly analyze their claims to determine whether any portion of their claims are subject to *bona fide* dispute as it could lead to the dismissal of the involuntary petition under 11 U.S.C. §303(b)(1). Equally important, creditors must properly strategize their collection and litigation efforts when pursuing their claims, because they cannot unilaterally allege that one or more portions of related claims are undisputed to qualify as petitioning creditors.

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