

MUST SEE TV AZTECA!

Bankruptcy Court Dismisses Involuntary Petition Based on Partially Disputed Claims

CREDITORS DEALING WITH A CUSTOMER THAT IS FAILING TO PAY ITS DEBTS CAN FILE AN INVOLUNTARY BANKRUPTCY PETITION AGAINST THAT CUSTOMER. HOWEVER, FORCING A CUSTOMER INTO AN INVOLUNTARY BANKRUPTCY IS NOT A DECISION TO BE TAKEN LIGHTLY. FAILURE TO SATISFY THE BANKRUPTCY CODE'S REQUIREMENTS FOR AN INVOLUNTARY PETITION RISKS NOT ONLY DISMISSAL OF THE BANKRUPTCY CASE, BUT ALSO EXPOSES THE PETITIONERS TO POTENTIALLY HUGE LIABILITY.

One of the requirements for an involuntary filing is that the creditors seeking relief (referred to as "petitioning creditors") must each have a claim that is not subject to a *bona fide* dispute as to liability or amount." This begs the question: is a partially disputed claim subject to a *bona fide* dispute that would deprive the creditor of standing to join an involuntary bankruptcy filing? Courts have historically reached conflicting holdings on this question. However, courts that have recently tackled this issue have held that a claim is subject to a *bona fide* dispute even where a portion of the claim is undisputed. A recent decision by the U.S. Bankruptcy Court for the Southern District of New York, in the involuntary bankruptcy cases of TV Azteca, S.A.B. de C.V. and its affiliates, is the latest to join this growing trend—even though the petitioning creditors didn't include the disputed portion of their claims as part of the involuntary petitions!

not contingent or the subject of a "bona fide dispute" as to liability or amount must join in filing an involuntary petition. This is supposed to discourage creditors from using an involuntary petition to coerce a debtor to pay debts to which the debtor had legitimate defenses.

This requirement was primarily at issue in TV Azteca.

2. If a debtor contests an involuntary petition, section 303(h)(1) requires the petitioning creditors to prove that the debtor is generally not paying its debts that are not otherwise subject to a *bona fide* dispute as to liability or amount as they become due.

If the petitioning creditors have satisfied all of section 303's requirements, the bankruptcy court will enter an order for relief on their involuntary bankruptcy petition, and the petitioning creditors can then assert an administrative expense priority claim for the fees they incurred prosecuting the petition. However, if the petitioning creditors fail to satisfy section 303's requirements and the involuntary petition is dismissed, the petitioning creditors risk facing huge liability. A debtor that successfully contests and obtains the dismissal of an involuntary bankruptcy petition can assert claims for damages and costs against the petitioning creditors. These claims are intended to compensate the debtor for the harm caused by an

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BACKGROUND ON INVOLUNTARY BANKRUPTCY PETITIONS

Under section 303 of the Bankruptcy Code, petitioning creditors seeking to commence an involuntary bankruptcy case against a debtor must meet two requirements:

1. If a debtor has twelve or more creditors, at least three creditors holding unsecured claims that total at least \$18,600 in the aggregate and **are**

improperly filed involuntary petition and discourage petitioning creditors from joining a frivolous involuntary petition. The bankruptcy court could require the petitioning creditors to pay a debtor's reasonable attorneys' fees or costs incurred in contesting the petition. The court could also award the debtor compensatory damages for its actual losses incurred as a result of the involuntary filing or, in the most egregious cases, punitive damages, if the court finds that the petitioning creditors had acted in bad faith.

THE BONA FIDE DISPUTE LIMITATION

Historically, the prevailing view was that a creditor's partially disputed claim was not subject to *bona fide* dispute and, therefore, did not disqualify the creditor from joining in an involuntary petition. However, in 2005, Congress amended Bankruptcy Code section 303(b)(1) to require that petitioning creditors' claims cannot be subject to a *bona fide* dispute "**as to liability or amount.**" This change has prompted courts to question the eligibility of petitioning creditors whose claims are partially disputed and has led to conflicting court rulings. Several courts have held that section 303(b)(1) treats any partially disputed claim as subject to a *bona fide* dispute because such a claim is disputed "as to amount." These courts disqualified creditors with partially disputed claims from joining an involuntary petition, regardless of how small the dispute may be. Other courts have interpreted section 303(b)(1) as merely clarifying prior legislative intent to focus primarily on liability issues regarding petitioning creditors' claims and not precluding creditors with

partially disputed claims from seeking involuntary bankruptcy relief.

That said, the legal landscape is trending toward a strict interpretation of section 303(b)(1)'s "*bona fide* dispute" limitation. The U.S. Courts of Appeals for the First, Fifth, and the Ninth Circuits, as well as other federal courts, have held that a dispute as to any portion of a claim constitutes a *bona fide* dispute that strips a creditor's standing to join an involuntary bankruptcy petition. The *TV Azteca* decision furthers that trend.

BACKGROUND REGARDING THE TV AZTECA DECISION

TV Azteca is a mass media and television company incorporated in Mexico. The company had issued \$400 million in unsecured notes that were governed by an indenture. As a result of TV Azteca's failure to pay interest due under the notes, the indenture trustee sent a notice of acceleration to TV Azteca seeking—for the benefit of all noteholders—full payment of all unpaid principal and interest, as well as a redemption premium in the amount of \$16 million allegedly due under the notes and indenture. The indenture trustee then sued TV Azteca to recover these amounts. TV Azteca did not dispute the principal and interest portion of the claim; however, TV Azteca disputed that it owed any redemption premium.

On Mar. 20, 2023, three noteholders filed involuntary bankruptcy petitions against TV Azteca and its affiliates in the U.S. Bankruptcy Court for the Southern District of New York. The petitioning creditors asserted claims for over \$60 million in principal and interest that was owed



to them under their notes and the indenture. Notably, the petitioning creditors did not assert any right to the disputed redemption premium in connection with the involuntary petitions.

On April 25, 2023, TV Azteca filed a motion to dismiss the involuntary petitions. TV Azteca asserted numerous arguments in support of dismissal. However, only one was needed to carry the day: the petitioning creditors lacked standing because their claims were subject to *bona fide* dispute as to amount.

Again, TV Azteca did not dispute the principal and interest owed under the notes. Instead, TV Azteca asserted the petitioning creditors' claims were subject to *bona fide* dispute because TV Azteca disputed the redemption premium the indenture trustee was seeking to recover as part of its litigation on behalf of all noteholders, including the petitioning creditors. In response, the petitioning creditors argued that the claims asserted in the involuntary petitions were not subject to *bona fide* dispute because the claims did not include the disputed redemption premium and the petitioning creditors were not parties to the indenture trustee's litigation against TV Azteca.

THE BANKRUPTCY COURT'S DECISION

The Bankruptcy Court dismissed the involuntary petitions, holding the petitioning creditors' claims were subject to *bona fide* dispute as to amount. It did not matter that the claims asserted in the involuntary petitions were limited to the undisputed principal and interest owed under the notes. The Bankruptcy Court concluded the disputed redemption premium was inseparable from the other claims under the notes and the court could not ignore that dispute simply because petitioning creditors excluded the redemption premium from their claims.

The Bankruptcy Court relied on the emerging majority view that a claim is subject to *bona fide* dispute even if only a portion of the claim is disputed. It did not matter that the petitioning creditors did not assert the disputed redemption premium in the involuntary petitions. The Bankruptcy Court reasoned that the right to the redemption premium (if any) arose under the same notes and indenture that were the basis for the petitioners' claims for principal and interest. Also, regardless of what the petitioning creditors asserted in the involuntary petitions, the indenture trustee was simultaneously seeking to recover the redemption premium for the benefit of *all* noteholders, including the petitioning creditors, in the indenture trustee's litigation against TV Azteca. The petitioning creditors were well aware of this—they were part of the group of noteholders that directed the indenture trustee to accelerate the payments due under the notes and were represented by the same counsel that was representing the indenture trustee in the litigation. And the icing on the

cake? That same counsel indicated to the Bankruptcy Court that the indenture trustee intended to file a proof of claim in the involuntary bankruptcy cases on behalf of all noteholders (including the petitioning creditors) that would have included the disputed redemption premium.

The Bankruptcy Court could not "blithely ignore" that the petitioning creditors' claims based on the notes and indenture inherently included the disputed redemption premium that the indenture trustee was seeking to recover on their behalf. The Bankruptcy Court noted that the petitioning creditors could not waive their right to the redemption premium under the notes and indenture since they were not the only parties to the notes and indenture—they could not unilaterally determine the amounts due and owing under those documents.

CONCLUSION

The *TV Azteca* decision further solidifies the trend of strictly interpreting the *bona fide* dispute limitation on a petitioning creditor's eligibility to join an involuntary bankruptcy filing. While other courts might rule differently than the *TV Azteca* court, creditors that are considering forcing a financially distressed customer into an involuntary bankruptcy proceeding should do their diligence to ensure that no portion of their claims is disputed. Otherwise, the involuntary petition may ultimately be dismissed, and the petitioning creditors may face significant sanctions for filing it. **BC**



BRUCE NATHAN, Partner, Lowenstein Sandler LLP's Bankruptcy & Restructuring Department, bnathan@lowenstein.com. With approximately 45 years of experience in the bankruptcy and insolvency field, Bruce

is a recognized nationwide leader in trade creditor rights and the representation of trade creditors. Bruce has represented trade and other unsecured creditors, unsecured creditors' committees, secured creditors, and other interested parties in many of the larger Chapter 11 cases that have been filed.



MICHAEL PAPANDREA, Counsel, Lowenstein Sandler LLP's Bankruptcy & Restructuring Department, mpapandrea@lowenstein.com. Mike provides counsel to debtors, creditors' committees, trade creditors, liquidating

trustees, and other interested parties with respect to corporate bankruptcy and creditors' rights matters, including bankruptcy-related litigation. As a seasoned creditors' rights advocate, Mike works tirelessly to understand clients' needs and provide practical solutions that are reasonable, balanced, and favorable to the clients he serves.