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Chapter 11 Venue: The Interest of Justice

By Peter C. Blain

Venue of Chapter 11 cases is governed by section 1408 of title 28, which provides in part that a case under the Bankruptcy Code (11 U.S.C. § 101 et seq) may be commenced in the district in which the person's "domicile, residence, principal place of business… or principal asset" are located, or "in which there is a pending case …of such person's affiliate." In In re Ocean Properties of Delaware, Inc., 95 B.R. 304 (Bankr. D. Del. 1988), the court determined that the state of incorporation is sufficient domicile for venue, notwithstanding where the debtor maintains its principal place of business or its principal assets. After Ocean Properties and similar decisions, a majority of the largest and most complex business entities in the country used the state of incorporation basis for venue to file Chapter 11 cases in the Southern District of New York ("SDNY") or the District of Delaware ("Delaware").

Those that support this trend argue that concentrating the adjudication of complex Chapter 11's in these districts enhances efficiency, accessibility, predictability and takes advantage of those courts' superior knowledge of corporate law principles. The courts in Delaware and the SDNY have developed critical special expertise that is not found in bankruptcy courts elsewhere, and this expertise, they argue, enhances the prospect for success. See generally Harvey R. Miller, Chapter 11 Reorganization Cases and the Delaware Myth, 55 Vand. L. Rev. 1987 (2002).

Critics of this trend argue that courts in Delaware and the SDNY entice companies to file there because those courts employ reorganisation requirements less stringently. As a consequence, companies confirming reorganisation plans in those districts are more likely to fail post-Chapter 11 than are companies which are reorganised in other jurisdictions. See Lynn M. LoPucki & Sara D. Kalin, The Failure of Public Company Bankruptcies in Delaware and New York: Empirical Evidence of a "Race to the Bottom," 54 Vand. L. Rev. 231 (2001). Bankruptcy judges in other jurisdictions, say these critics, are just as able as those in Delaware and New York, and statistically, they have a better overall track record of success. In addition, those courts are more accessible to local creditors, including employees and retirees, and those creditors are more likely to fully participate in a case filed where the business is located.

Under section 1412 of title 28, a court may transfer venue to a different bankruptcy court "in the interest of justice" and for the "convenience of the parties." Recently, in In re Patriot Coal Corp., 482 B.R. 718 (Bankr. S.D.N.Y. 2012), a bankruptcy judge applied section 1412 to transfer the Chapter 11 venue of one of the largest coal companies in the United States from the SDNY to the Eastern District of Missouri. In early June 2012, two subsidiaries of the main debtor, Patriot Coal Corporation, were incorporated in New York. The entities had no operations in the state and conducted no business there. On July 9, 2012, relying on the affiliate provisions of section 1408, Patriot Coal Corporation and ninety-eight of its subsidiaries filed Chapter 11 petitions in the SDNY. The United Mine Workers of America ("UMWA") promptly filed a motion to change venue to the Southern District of West Virginia. This motion was joined by a number of creditors. Thereafter, the US Trustee filed a motion to change venue, but did not specify a jurisdiction. This motion was also joined by a number of creditors. Both motions were opposed by the debtors, the unsecured creditors committee and a number of creditors.

In her decision, Bankruptcy Judge Shelley C. Chapman started by enumerating all of the connections of the various constituencies to various states. The debtors' headquarters are in St. Louis, Missouri, and its operations are principally located in West Virginia, Missouri and Kentucky. In addition to these states, the debtors' leases coal fields in Illinois, Indiana, Ohio and Pennsylvania. The debtors' largest bond holders and secured creditors are located in New York. A majority of the debtors' 4,000 employees and almost 12,000 retirees live in West Virginia and the Illinois Basin region. The debtors' largest unsecured creditor is located in Delaware, and other large creditors are located in various states, including West Virginia and California.

In analysing the motions to change venue, the court noted that a debtor's selection of venue is entitled to deference and that the Patriot Coal petitions were not filed in bad faith. Given the existing venue statute, the petitions were filed in compliance with the strict letter of the statute. In fact, the court noted that the debtors' likely had a fiduciary obligation to consider all possible venues. However, literal compliance with the venue statute is not sufficient. Relying upon the federal tax law concept of substance over form first described in Gregory v. Helvering, 293 U.S. 465 (1935), the court said it must not only consider whether the statute was complied with, but it must also take into account how it was complied with. Creating affiliate shell subsidiaries weeks before the petitions were filed manufactured venue where none existed. The court, citing Gregory, said "what was done was not 'the thing which the statute intended'." The court concluded that the venue of the case must be transferred.

In considering where to transfer venue under section 1412 and the dual prongs of "interest of justice" and "convenience of the parties", the court rejected arguments made by the movants to transfer venue to West Virginia and the objecting parties to retain jurisdiction in the SDNY. The court acknowledged that the debtors' lenders and most of the professionals in the case were located in New York. However, the debtor had no meaningful presence in New York and to "bootstrap" venue based upon the location of the professionals in the case did not comport with the interest of justice prong. The UMWA argued that judges in West Virginia who "live near coal miners, grew up with them, worship with them and break bread with them" understand coal miners.

Consequently, the debtors' employees and retirees would be more accepting of such court's decision as opposed to a "court very far away" where the "financiers and the bankers" are located. The court responded that selecting a forum such as West Virginia which would give one group of constituents a seeming advantage would be worse than retaining jurisdiction in the SDNY.

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Finally, while the court acknowledged that transferring venue would require additional cost, she said that cost imposed by doing justice is sometimes required to ensure the integrity of the nation's laws. The court said that whether the costs of transferring venue were de minimus or material they must be borne.

After considering the alternatives, the court transferred venue of the cases to the Bankruptcy Court for Eastern District of Missouri. The debtors' headquarters are located in St. Louis, where the court sits, and that city is accessible to the majority of the debtors' employees and retirees.

Using the state of incorporation of the debtor or an affiliate is considered a "loophole" by many who maintain that finding that venue is not illegal does not mean that it is fair. These parties maintain that the venue statute should be changed to require a petition filing in the district where the debtor's principal place of business or principal assets are located, or in the district where an affiliate which owns a majority of the equity of the petitioner is a debtor. In 2011, H.R. 2533, 112th Cong. (2011) was introduced to do just that.

The bill wasn't enacted, however, and supporters of the existing venue statute argue that this fact is evidence that Congress is aware of the proposed venue "loophole" and has declined to remedy it. Opponents, who continue to actively lobby for venue reform, dismiss this argument, observing that like almost everything else today, bankruptcy venue reform is a politically charged topic and failure to pass particular legislation is no reflection on its merit. Reform may be an elusive goal, however. Senator Chris Coons (D-Del.) was recently appointed as Chairman of the Judiciary Committee's Subcommittee on Bankruptcy and Courts. Senator Coons has publically supported the existing venue statute and lauds the expertise of Delaware bankruptcy courts in handling complex Chapter 11 cases. Mr. Coon's appointment makes it highly unlikely bankruptcy venue reform will occur in the near future. Until then, decisions like Patriot Coal may have to serve as a shield against intentional abuse of the venue statute.

Peter C. Blain is the head of the Corporate Reorganization Practice Group of the Milwaukee, Wisconsin law firm of Reinhart Boerner Van Deuren, s.c. He is a Fellow in the American College of Bankruptcy and has been included in Best Lawyers in America since 1987.

Currently, he is Co-Chair of the Bankruptcy Subcommittee of the Eastern District of Wisconsin Bar Association and has served as past Chair of the Bankruptcy Insolvency and Creditors Rights Section of the Wisconsin Bar Association and Chair of the Bankruptcy Section of the Milwaukee Bar Association. Mr. Blain frequently speaks and writes on bankruptcy topics.

Peter can be contacted by phone on +1 414 298 8129 or alternatively via email at pblain@reinhartlaw.com