

## Bankruptcy Court Rejects Forum-Shopping Ploy

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It has become a reality of bankruptcy practice that most large or complex Chapter 11 cases are filed and administered in one of two so-called "magnet districts" — Delaware or the Southern District of New York (Manhattan) — irrespective of the location of the debtor's principal place of business, principal assets, creditors or employees. The law that enables this to happen is 28 U.S.C. §1408, which permits a debtor to file for bankruptcy in the district in which it has: (1) its domicile (for a corporation, its state of incorporation); (2) its residence; (3) its principal place of business; or (4) its principal assets.

In addition, a corporation can file where there is a pending case concerning one or more of its affiliates, which can include not only a wholly-owned subsidiary, but a corporation in which the filing corporation holds at least a 20 percent equity interest. This means that no matter how large the parent corporation's headquarters are or where it is located, the parent can bootstrap the entire corporate family into the venue of a small affiliate.

A number of Connecticut-based companies have taken advantage of the alternatives afforded by the statute to file Chapter 11 cases in Delaware or New York. They have included Southern Air (based in Norwalk and filed in Delaware), SP Newsprint (based in Greenwich and filed in Delaware), Ames Dept. Stores (based in Rocky Hill and filed in New York) and Caldor (based in Norwalk and filed in New York).

A recent, extreme example of bankruptcy forum shopping was presented in the case of *In re Patriot Coal Corp.*, 2012 WL 5934334 (Bankr. S.D.N.Y. Nov. 27, 2012). In that case, the debtor, Patriot Coal Corp., although headquartered in St. Louis, attempted to establish venue in the Southern District of New York by the incorporation of two subsidiaries in New York about one month before their bankruptcy filings.

The subsidiaries had no employees or business operations and did not even have an office in New York. One subsidiary's assets, however, consisted of \$97,000 in a checking account that had been opened up with Capital One Bank in Manhattan, and the other's consisted of a 100 percent membership interest in another Patriot company, the certificate for which was held in Manhattan by an agent for a Patriot lender.

On the same day that the subsidiaries filed bankruptcy petitions in the Southern District of New York, Patriot Coal and 96 of its other subsidiaries filed their own Chapter 11 petitions in the same court based on the venue of the newly created "affiliates." Shortly thereafter, pursuant to 28 U.S.C. §1412, the United Mine Workers of America and some of Patriot's sureties filed motions to transfer venue of the cases to West Virginia, where some of the debtors' mining operations were conducted.

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Under that statute, venue of a bankruptcy case may be transferred to another district "in the interest of justice or for the convenience of the parties." The transfer motions were joined or supported by the West Virginia Attorney General, the Kentucky environmental department and three big utility companies.

Based principally on the debtors' acknowledgement that Patriot's New York subsidiaries were formed for no other purpose but to establish venue for all of the cases, the bankruptcy court held that "in the interest of justice" the cases had to be transferred.

However, in balancing the interests of other constituents in the cases, including other creditors, the majority of whom were located in states other than West Virginia, and giving further weight to the fact that Patriot's corporate headquarters and books and records were all in St. Louis, the bankruptcy court transferred all of the cases to the Eastern District of Missouri.

While one might expect that artificially creating venue in the manner attempted in Patriot Coal would not withstand judicial scrutiny, a perceived systematic misuse of the bankruptcy venue statute has led to a call for legislative reform. H.R. 2533, the "Chapter 11 Bankruptcy Venue Reform Act of 2011," was introduced in the U.S. House of Representatives in September 2011. The bill's objective is to make it harder for companies to file for bankruptcy in Delaware and New York by removing corporate domicile (state of incorporation) as a basis for venue and making the affiliate filing rule more stringent for Chapter 11 filings by corporations.

Under H.R. 2533, a corporate debtor would be permitted to file its case only in the district that encompasses its principal place of business or where its principal assets were located for the year preceding the bankruptcy filing. If the debtor's location was divided between two or more districts within that one-year period, venue would be proper only in the district in which the debtor had its principal place of business or principal assets the longest.

The affiliate filing rule would also be restricted by allowing "affiliate" filings to take place only in the district where there is a pending Chapter 11 case of a parent company that owns more than 50 percent of the stock of the affiliate. This would prevent venue being established for a parent company by an initial Chapter 11 filing by its wholly or partially owned subsidiary.

H.R. 2533 has been met with congressional inaction, however, leaving bankruptcy venue reform uncertain. But, as observed by the bankruptcy court in Patriot Coal, "given the current political climate in Congress, its inaction on H.R. 2533 can hardly be viewed as a decision on the merits of the proposal to remove domicile as a predicate for venue and/or to abolish or modify the affiliate filing rule." We will have to wait and see if that decision will ever be put to Congress.

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