

# Client Alert

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Finance Department

## Revisiting Venue: *Patriot Coal* and the "Interest of Justice"

On November 27, 2012, Judge Shelley C. Chapman of the United States Bankruptcy Court for the Southern District of New York issued an opinion in *In re Patriot Coal Corporation*<sup>1</sup> transferring the chapter 11 proceedings pending before her to the Eastern District of Missouri. Judge Chapman's thorough and important 55-page opinion focuses on the debtors' incorporation of two shell companies in New York within six weeks of the petition date for the sole purpose of establishing venue in the Southern District of New York under Section 1408 of title 28 of the United States Code (the "US Code") and how such "eve of filing" actions should be considered in the context of adjudicating venue challenges. The court's ultimate holding that the debtors' actions on the eve of bankruptcy warranted a transfer of venue "in the interest of justice" has potentially significant implications that may alter the landscape for corporations preparing for bankruptcy and making chapter 11 venue decisions.

This *Client Alert* provides a brief discussion of the *Patriot* opinion and its possible impact on chapter 11 planning decisions.

### Background

On July 9, 2012, Patriot Coal Corporation and 98 of its subsidiaries filed voluntary petitions for relief under chapter 11 of the Bankruptcy Code in the Bankruptcy Court for the Southern District of New York. Two subsidiaries, PCX Enterprises, Inc. and Patriot Beaver Dam Holdings, LLC, were formed under the laws of the State of New York on June 1 and June 14, 2012, respectively. The debtors stipulated as part of the record before the bankruptcy court that they created these two subsidiaries on the eve of the bankruptcy filing solely for the purpose of establishing venue in the Southern District of New York pursuant to Section 1408 of the US Code.<sup>2</sup> According to the debtors, filing in New York was in the best interests of their creditors and other stakeholders and would result in lower cost and greater efficiency in administering the estates than filing in other available venues,<sup>3</sup> particularly because the professionals of the debtors and other large parties-in-interest were located in New York.

Shortly after the petition date, the United Mine Workers of America (UMWA) filed a motion pursuant to Section 1412<sup>4</sup> of the US Code requesting that the court transfer the chapter 11 cases to the Southern District of West Virginia "in the interest of

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justice and for the convenience of the parties." This motion was followed by a similar motion filed by certain insurance companies, as sureties of the debtors. Two additional parties, including the West Virginia Attorney General, joined in the motions.<sup>5</sup> The US Trustee filed a separate motion for entry of an order transferring venue "in the interest of justice" "to a district where venue is proper."<sup>6</sup> The debtors, the official committee of unsecured creditors, and the administrative agent under the debtors' debtor-in-possession facility each filed objections to the motions to transfer, and numerous unsecured creditors, including many of the largest unsecured creditors in the case, supported the debtors' objection. The UMWA, the sureties and the US Trustee each filed replies in response.<sup>7</sup>

## Decision

After a thorough review of the facts and applicable law, Judge Chapman granted the US Trustee's motion to transfer and held that the proper venue for the debtors' cases is the Eastern District of Missouri, where, among other things, the debtors' headquarters, executive offices and management team are located.

The bankruptcy court reached this holding after an extensive<sup>8</sup> analysis of the statutory and case law pertaining to venue. In particular, the court explained that Section 1412 of the US Code is written in the disjunctive, meaning that each of the two prongs — "in the interest of justice" or "for the convenience of the parties" — constitutes an independent ground for transferring venue. In addition, the court expressly noted that the integrity of the bankruptcy courts and the bankruptcy process may be a relevant factor in determining whether a transfer of venue is appropriate.

Judge Chapman's opinion focused on the fact that the debtors had incorporated their two New York subsidiaries for the sole purpose of achieving compliance with the venue statute. To this point, she expressly held that the creation of the subsidiaries for this purpose and the filing of the chapter 11 cases in the Southern District of New York was *not* in bad faith and technically complied with the venue statute. In fact, Judge Chapman specifically stated that, to the extent venue in New York would truly benefit the debtors' estates, the debtors may have actually had a duty to take necessary steps to establish jurisdiction in that venue. Nevertheless, she determined that such "eve of filing" strategies must be considered as part of the "interest of justice" analysis conducted under Section 1412 of the US Code. Perhaps most importantly, while Judge Chapman acknowledged that the debtors "achieved literal and technical compliance with the venue statute," she stressed that "*how* they complied with the statute must be taken into account." Because creating subsidiaries solely for the purpose of establishing venue is not "the thing which the statute intended"<sup>9</sup> she found that venue must be transferred in order to avoid "elevat[ing] form over substance in a way that would be an affront to the purpose of the bankruptcy venue statute and the integrity of the bankruptcy system."

In reaching its holding, the court looked to and relied on the opinion of Judge Drain in *In re Winn-Dixie Stores, Inc.*,<sup>10</sup> a case in which, as here, the debtors created an affiliate solely to establish venue under Section 1408 of the US Code. The court in *Winn-Dixie* distinguished cases where "the facts were created to fit the statute," from cases where the debtors were simply "applying the statute to fit the facts." Employing this framework, Judge Chapman determined that allowing the debtors' cases to remain in New York would render the venue statute meaningless and allow corporate debtors to manufacture venue simply by incorporating an affiliate in any venue that would prove beneficial immediately prior to filing for chapter 11,

without any consideration of the interests of justice or convenience to the parties. Further, the court rejected the debtors' argument that venue was proper because the key professionals of the debtors and other large parties in interest were located in New York, explaining that basing venue on this fact alone would be "condoning a 'bootstrap' venue selection strategy that is at odds with the purpose of the venue statute, and with the interest of justice."<sup>11</sup> However, Judge Chapman expressly left open the question of whether, had the debtors not created the subsidiaries solely for venue purposes, the cases would otherwise have been allowed to proceed in the Southern District of New York despite the debtors' limited direct ties to the district.<sup>12</sup>

After determining that the "interest of justice" required that the cases be moved, the bankruptcy court then addressed the question of where the cases should be transferred. Judge Chapman dismissed the arguments of the UMWA and the sureties that the proceedings should be moved to West Virginia because nine of the debtors' 12 mining operations and a large number<sup>13</sup> of employees are located there, finding that the movants failed to meet their burden of demonstrating that either the "interest of justice" or the "convenience of the parties" supported the transfer to West Virginia. In response to the argument that the bankruptcy court in West Virginia would be more familiar with the coal mining industry and thus a better venue, Judge Chapman noted that "personal knowledge of the facts at issue in a case by the trier of fact ceased long ago to be a venue consideration" and further explained that transferring venue to a different district where one party feels the court may be more empathetic to its cause would simply "swap one party's perceived home field advantage for another."<sup>14</sup> The bankruptcy court also rejected the movants' arguments that transfer to West Virginia was required for the convenience of the parties; as Judge Chapman put it, "fairness, rather than geography . . . has been and should continue to be the key factor in determining the appropriateness of venue" and Section 1412 of the US Code requires the court to focus on the interests and convenience of *all* parties, including those creditors and lenders who had supported venue in New York.<sup>15</sup>

Ultimately, the court held that transfer of venue to the Eastern District of Missouri serves the interest of justice and best serves the convenience of the parties because the debtors' corporate headquarters and executive offices are located in St. Louis, Missouri, their books and records are kept there, several members of the debtors' executive management team work in St. Louis, and St. Louis is easily accessible by those parties-in-interest required to travel to the hearings.

## **Implications for Corporations**

Judge Chapman was careful to make clear in her opinion that the holding of *Patriot* is limited to certain circumstances in which a debtor attempts to "create" facts that will fit the letter of the law, rather than instances where a debtor may, by happenstance or thoughtful, advance planning, already have existing facts that fit the law, like circumstances in which prospective debtors may have incorporated an entity in a particular venue for another purpose altogether. Nevertheless, this decision has important implications for all corporations, whether or not they are currently considering filing for bankruptcy:

- Literal compliance with the venue requirements set forth in Section 1408 of the US Code may be insufficient to withstand a motion to transfer venue under Section 1412 of the US Code where a bankruptcy court finds that the "interest of justice" requires a transfer to another venue. In a broader sense, the *Patriot* decision may well encourage courts to analyze whether literal compliance with

other statutes is enough where applicable laws grant courts the authority to consider overall fairness and equity in applying such statutes.

- Steps taken by parties on the eve of filing for bankruptcy are likely to be among the factors considered in the “interest of justice” analysis applied by courts under Section 1412 of the US Code. Further, a debtor’s effort to create facts to meet the requirements of Section 1408 of the US Code may in itself cause a bankruptcy court to require a transfer in the “interest of justice.”
- Corporations would be prudent to consider venue requirements in advance, regardless of whether a bankruptcy filing is on the horizon, in order to determine how best to maintain a corporate structure flexible enough to take advantage of the best venue options possible should a bankruptcy filing ever become necessary.
- Although the financial and banking industry has a strong presence in New York and many restructuring and financial professionals maintain offices in New York, such facts standing alone may not be sufficient to convince a bankruptcy court to keep a case in New York under the interest of justice and convenience of parties tests, at least not in the face of a finding that a subsidiary was formed to create venue in New York largely for this purpose.
- The *Patriot* decision may motivate Congress to reopen assessment of the venue rules under the US Code, potentially close the “loophole” that the debtors attempted to employ to establish venue in their district of choice and create more defined rules regarding forum shopping and venue selection.
- Notwithstanding the *Patriot* decision, the question remains whether corporations will continue to make strategic business and filing planning decisions aimed at establishing venue in the jurisdiction prospective debtors view as most advantageous to their restructuring goals.
- The *Patriot* decision is a good reminder that bankruptcy courts and judges will examine closely “eve of filing” and other actions that potentially implicate the integrity of the bankruptcy system.

**Endnotes**

- <sup>1</sup> *In re Patriot Coal Corporation*, Case No. 12-12900 (SCC) (Bankr. S.D.N.Y. Nov. 27, 2012).
- <sup>2</sup> Section 1408 of the US Code provides: "Except as provided in section 1410 of this title, a case under title 11 may be commenced in the district court for the district — (1) in which the domicile, residence, principal place of business in the United States, or principal assets in the United States, of the person or entity that is the subject of such case have been located for the one hundred and eighty days immediately preceding such commencement, or for a longer portion of such one-hundred-and-eighty day period than the domicile, residence, or principal place of business, in the United States, or principal assets in the United States, of such person were located in any other district; or (2) in which there is pending a case under title 11 concerning such person's affiliate, general partner, or partnership." 28 U.S.C. § 1408.
- <sup>3</sup> Whether venue in a particular district is proper is a separate and distinct issue than whether the court in such district has jurisdiction over a matter. Jurisdiction involves the court's power to adjudicate a case, is proscribed by Congress and cannot be created by waiver or consent of the parties-in-interest.
- <sup>4</sup> Section 1412 of the US Code provides that "[a] district court may transfer a case or proceeding under title 11 to a district court for another district, in the interest of justice or for the convenience of the parties." 28 U.S.C. § 1412.
- <sup>5</sup> Additionally, the Commonwealth of Kentucky, Energy and Environmental Cabinet, Department for Natural Resources filed a notice expressing support for the request for transfer to the Southern District of West Virginia.
- <sup>6</sup> The UMWA health and retirement funds and an informal group of shareholders each filed a joinder to the US Trustee's motion.
- <sup>7</sup> Prior to the hearing on the motions, the debtors, each of the movants, and the committee of unsecured creditors entered into a stipulation of facts pursuant to which the declarations of each of the parties were entered into evidence and the parties agreed not to examine any of the declarants, conduct any discovery or present any testimony at the hearing. Accordingly, the bankruptcy court's decision turned on its interpretation of the venue laws and their applicability to these stipulated facts. Nonetheless, Judge Chapman's opinion is quite careful in laying out the extensive factual record that ultimately supported her decision as to which venue choice would best serve the interest of justice and the convenience of the parties.
- <sup>8</sup> Indeed, Judge Chapman's opinion includes a survey of the history and development of the concept of venue under English law dating back to the 1200's and its relation to the adoption in America of the Federal Judiciary Act of 1789.
- <sup>9</sup> *Gregory v. Helvering*, 293 U.S. 465, 469 (1985)
- <sup>10</sup> *In re Winn-Dixie Stores, Inc.*, Case No. 05-11063 (RDD) (Bankr. S.D.N.Y. April 12, 2005).
- <sup>11</sup> The court also noted that if a debtor were able to assert proper venue wherever its key professionals are located, it would enable debtors in almost any case to file in the Southern District of New York just by virtue of its selection of restructuring professionals.
- <sup>12</sup> The bankruptcy court also acknowledged that transferring the cases may have economic consequences for the debtors, including the possibility of increased costs for the estates. However, the court found that this should not be a dispositive factor in cases where transfer is necessary to protect the integrity of the bankruptcy court system.
- <sup>13</sup> Approximately 42 percent of the debtors' employees are members of the UMWA and located in West Virginia.
- <sup>14</sup> Judge Chapman specifically noted in her opinion the UMWA's suggestion that "fairness" requires that the chapter 11 cases be transferred because judges in the Southern District of New York would be less sympathetic to the plight of the coal miners than judges in West Virginia who, according to the UMWA, "live near coal miners, grew up with them, worship with them and break bread with them," but "categorically" rejected "such a parochial formulation of justice."
- <sup>15</sup> The bankruptcy court also explained that the location of a debtor's assets is not essential to a venue analysis, particularly where the debtor is reorganizing, rather than liquidating.

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