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Inside

Venue Transferred

Houghton Mifflin and Patriot Coal Show It's Possible

by Julie Schaeffer

Parties to bankruptcies are continuing to grumble about the filing of large cases in New York or Delaware, rather than the business's actual location.

"Venue is certainly a hot topic among bankruptcy academics, not to mention some legislators who recently introduced legislation in Congress to limit venue choice. They oppose the concentration of large Chapter 11 cases in Manhattan and Delaware as forum shopping, and contend that the competition for large cases results in skewed bankruptcy decisions intended to make jurisdictions more attractive to troubled companies," says Alan Zimmerman, associate director at Standard & Poor's Leveraged Commentary & Data.

Although Zimmerman notes that actual litigated challenges to venue in large corporate cases are relatively rare, there have been two notable recent exceptions: Houghton Mifflin Harcourt Publishing Company and Patriot Coal.

Houghton Mifflin Harcourt Publishing was created when Barry O'Callaghan, a former Irish investment banker, bought Harcourt Education and Houghton Mifflin for $7.4 billion. The transaction left the educational publishing company with substantial debt that it struggled to pay off. In May 2012, the company filed a prepackaged Chapter 11 petition in the Southern District of New York with the support of more than 70 percent of its creditors, who agreed to exchange their debt for equity.

Then, the U.S. trustee in the case stepped in and filed a motion to transfer the case to the District of Massachusetts on the grounds that Houghton Mifflin Harcourt Publishing's contacts with New York "did not meet the statutory criteria necessary for the court to find that venue in this district is proper." Among other things, the company's principal place of business was Boston, and only 75 of its 3,300 employees and 0.3% of its assets were located in New York.

Houghton did not challenge these facts, instead arguing that its ties to New York (including the business activities of subsidiaries that earned $220,000 annually) were sufficient to file there. Additionally, the company argued that New York was the most convenient location for all the parties involved in the Chapter 11 case, including key creditors, lenders, and advisors.

In June 2012, Judge Robert E. Gerber of the U.S. Bankruptcy Court for the Southern District of New York granted the U.S. trustee's motion to transfer the Chapter 11 to the District of Massachusetts. "Happily, however, he did not permit the granting of the U.S. trustee's motion to delay the confirmation proceedings," says Paul Rubin, a partner at Herrick Feinstein LLP. "Instead, he first confirmed the plan of reorganization, and then transferred venue, so his practical ruling did not delay the restructuring." Gerber did so on the grounds that the mandatory venue transfer statute is silent as to when a transfer must occur.

Patriot Coal, based in St. Louis, Missouri, conducts mining operations at 12 locations, nine in West Virginia and three in Kentucky. It, along with other coal companies, was hit hard by a decline in demand, arising in part from a weaker economy and tougher environmental rules. From 2010 through 2012, the company lost money every year, reporting a $198.5 million loss in the fiscal year ending March 31, 2012.

In June 2012, Patriot Coal decided to file for Chapter 11, but, before it did, it created

Venue, *from page 1*

two new entities (which had no offices or employees) under the laws of the state of New York for the sole purpose of ensuring that it could file for bankruptcy in the Southern District of New York. Then, 38 days later, Patriot Coal filed 99 Chapter 11 petitions in the Southern District of New York for itself and each of its various subsidiaries and affiliates. Only two were incorporated under New York law and domiciled in New York. Of the other 97, 54 were incorporated in West Virginia, 40 were incorporated in Missouri, and 3 were incorporated in Kentucky.

Subsequently, numerous parties, including the United Mine Workers of America (UMWA) and the United States trustee's office, filed motions to transfer the bankruptcy elsewhere. The U.S. trustee went so far as to allege that allowing the case to remain in the Southern District of New York would "raise serious questions about the efficacy of Congress's bankruptcy venue system as a whole" and "violates the interest-of-justice standard."

Patriot Coal argued that the Southern District of New York was the appropriate venue because the parties who would be most active in the case (i.e. the debtors' lawyers, financial advisors, and the DIP lender) were located in New York, and reducing their travel expenses would increase creditors' recovery.

In November 2012, Judge Shelley C. Chapman of the U.S. Bankruptcy Court for the Southern District of New York transferred Patriot Coal Corporation's Chapter 11 case to the Eastern District of Missouri, where the company is headquartered.

According to Chapman, the transfer was necessary, in part, because of the standard set forth in *In re Winn-Dixie Stores, Inc.*, which held that "the interests of justice require transfer where…the facts were created to fit the statute [instead of]… applying the statute to fit the facts."

The decision surprised many, given that other large cases filed in the Southern District of New York (including Enron) had failed in attempts to change venue. It was also surprising where the case was transferred: to the Eastern District of Missouri, where Patriot Coal maintains its corporate headquarters, instead of to the Southern District of West Virginia, as requested by the UMWA.

According to Rubin, Houghton Mifflin illustrates that even a lone dissenting party can raise venue and transfer arguments.

"As Judge Gerber warned, the venue transfer rules 'can subject the entire creditor community to the actions of a gadfly or an entity with a private or political agenda, even if creditor convenience, avoiding unnecessary expense, and the interests of justice cry out for keeping the case where it is,'" he says.

Rubin adds that "careful attention must be paid to the selection of proper venue, and debtors must be prepared to substantiate their venue decisions under the bankruptcy venue statute. Debtors and creditors negotiating prepackaged plans will need to give careful consideration to the validity of their preferred venue."

On a broader note, Eric English, a financial structuring senior associate in King & Spalding's Houston office, says the Patriot Coal opinion "may signal a more receptive attitude towards transfers of venue away from the Southern District of New York, at least where venue is created on the eve of bankruptcy and requests to transfer garner some support from economic parties in interest." ¤