AMERICAN BANKRUPTCY INSTITUTE

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Why Venue Matters in Chapter 11 Cases

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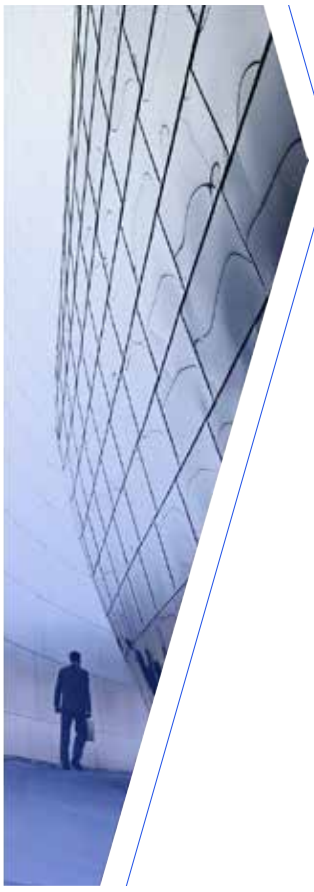

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Agenda

Overview

- **Venue Has an Impact on Any Chapter 11 Case**
  - Interpretation of certain legal issues can vary among circuits and bankruptcy courts within such circuits.
  - Venue decisions are weighed against the possibility that certain parties in interest may contest the debtor's choice of venue–a process that can be costly hugely disturbing to the reorganization.
- **Threshold Considerations (among others)**
  - A court's experience handling similar cases in certain industries (*e.g.*, oil/gas cases in S.D. Tex. or coal cases in Ohio);
  - Precedent;
  - Speed; efficiency, and access;
  - Geographical advantages; and
  - Convenience to debtors and/or creditors.

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Important Considerations That Impact the Venue Analysis

- **In addition to factors such as geographic proximity to the debtors and overall convenience, a venue analysis is also informed by determining what is important to the Company and what it intends to accomplish.**
- **Legal precedent–courts are split on many of the following issues, making the venue analysis complicated and nuanced**
  - **Assumption & Assignment of Executory Contracts Under Section 365(c) of the Bankruptcy Code**
    - Section 365(c)(1) prohibits a debtor from assuming contracts over a counterparty's objection where "applicable" law prohibits the assignment and the contract does not address assignability.
    - In applying section 365(c)(1) courts apply divergent tests:
      - "Actual" vs. "Hypothetical test
  - **Stub Rent**
    - Section 365(d) requires a debtor to remain current on "post-petition obligations" arising from a lease of nonresidential real property pending the decision to assume or reject the lease.
    - Courts differ on how such rental obligations are treated:
      - Billing approach v. proration approach can result in million-dollar-differences in rent obligations for debtors.
  - **Claim Classification**
    - Different circuits apply divergent analyses in evaluating the separation of similar claims.
  - **Rejection Damages**
    - Section 502(b) of the Bankruptcy Code limits a landlord's recovery under a theory of rejection damages to (i) rent due under the rejected lease for the greater of one year's rent or (ii) 15% of rent due under the lease, not to exceed three years' rent.
    - Courts are split regarding how to calculate the 15% in the second prong of the test.
      - Circuits following the "time remaining" test calculate the claim based on 15% of the remaining lease *term*.
      - Circuits applying the "rent amount" test use the remaining lease *dollar amount* as their base figure.

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Important Considerations (cont'd)

- **Artificial Impairment**
  - Section 1129(a)(10) of the Bankruptcy Code prohibits a plan from being confirmed where a class of claims is impaired under the plan, unless at least one impaired class accepts the plan.
  - Courts are split on whether artificially manufacturing an impaired accepting class constitutes a *per se* violation of section 1129(a)(10) and a *per se* demonstration of bad faith (potentially rendering the plan unconfirmable).
- **Severance Payments**
  - Debtors often seek venues that prorate severance benefits attributable to postpetition services provided to the estate in order to minimize front-loaded costs in the chapter 11 process.
- **Third-Party Releases**
  - Under section 524(e) of the Bankruptcy Code, a bankruptcy court does not have the authority to discharge non-debtors from liabilities owing to other non-debtors.
  - Some courts have interpreted section 524(e) to allow consensual third-party releases under general contract principles.
  - Other courts have approved *non*-consensual releases in narrow circumstances.
  - Some prohibit all creditor releases of non-debtors.
- **Debtor Releases**
  - Courts differ on how stringently they examine proposed releases of claims by debtors
  - Some courts require only "sound business judgment." (*e.g.*, the Second Circuit).
  - Other courts impose a more rigorous five-factor test (*e.g.*, Delaware).

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Venue Change Considerations

Venue change/transfer considerations largely turn on similar issues of precedent. While debtors choose a venue that they believe is in the best interest of the company, creditors may select to transfer to venues for their own self-interest or convenience.

There are a variety of judicial considerations that both judges and lawyers use when considering transfer motions. These fact-specific factors can be used to defend and attack a venue transfer motion.

- proximity of venue to assets, creditors, debtor, debtor's principals, evidence, and witnesses;
- willingness of parties to participate in the case if venue is changed;
- the economics of transfer;
- availability of compulsory process for attendance of unwilling witnesses and the cost of obtaining their attendance;
- applicability of state law to the case;
- intertwined relationships of the debtor;
- necessity of ancillary administration; and
- local interest in having localized controversies decided at home.

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Case Study: HVI Cat Canyon (Greka)

- Filed in Southern District of New York ("SDNY") on July 25, 2019.
- On August 14, 2019, creditors (Santa Barbara County Air Pollution Control District, County of Santa Barbara, California, and the Santa Barbara Treasurer and Tax Collector) filed a motion to transfer venue to the Central District of California.
  - The creditors argued that the debtor was not registered to do business in New York; only one creditor was located in New York; all members of the official committee of unsecured creditors were located in or near Santa Barbara County; three of the five secured creditors were in California; all of the Debtor's property held in the possession or custody of a third party was held in CA; all litigation involving the debtor (with the exception of one case in in Texas) was in California; and the debtor is named after Cat Canyon, which is an oil field located in Santa Barbara County.
  - The debtor objected on the basis that the debtor's had numerous connections to New York, including its corporate headquarters; the debtor's secured lenders, financial creditors, and professionals were all located in and around New York; the debtor had leased its corporate office space for almost 20 years; and the debtor's Chairman's office was in the New York office. The debtor also noted also that two of its credit agreements (amounting to 90% of total debt) were governed by New York law and specifically require New York jurisdiction. In lieu of remaining in New York the debtors suggested transferring to the Northern District of Texas, where one of their affiliates had a pending bankruptcy case.

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Case Study: HVI Cat Canyon (Greka) (cont'd)

- On August 23, 2019, the Official Committee of Unsecured Creditors (the "Committee") filed a statement in support of the motion to transfer.
  - The Committee stated that it agrees that the case does not belong in SDNY but requested that the Court transfer venue to the Northern District of Texas, where the debtor's affiliate, Rincon Island Partnership, filed a voluntary petition for chapter 7, which was ongoing.
  - The Committee argued that venue was proper in the Northern District of Texas because the Rincon case is similar to the Greka case, and the judge presiding over the Rincon case was familiar with the debtor, its affiliates, its operations, and the issues that might arise in the case.
- On August 26, 2019, the debtor filed a qualified joinder in the Committee's statement. The debtor argued that venue was proper in SDNY but also noted that venue may be proper in the Northern District of Texas for the reasons stated by the Committee.
- On August 28, 2019, SDNY granted the venue transfer motion and the case was transferred to the Northern District of Texas.
- Less than 2 weeks later, the California creditors renewed their request to transfer the venue to California. Arguments were heard at a hearing on September 10, 2019, and on September 12, 2019, the Court granted the venue transfer motion and transferred the case to the Central District of California.

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Case Study: White Star Petroleum, LLC

- Creditors filed an involuntary chapter 11 petition in the Western District of Oklahoma on May 24, 2019.
- White Star filed a voluntary chapter 11 petition in Delaware on May 28, 2019.
- On June 7, 2019, White Star filed (i) a motion for entry of an order determining that the Delaware case may proceed; and (ii) filed a motion to dismiss the involuntary case in Oklahoma.
- White Star argued that having the case proceed in Delaware was in the best interest of the estate and highlighted four key arguments:
  - Price – potential buyers in section 363 sale scenario would be more comfortable with Delaware law regarding section 363 sales and that permitting the Delaware case to proceed would increase participation in an auction.
  - Efficiency – Delaware law would permit streamlined negotiations with potential buyers.
  - Cost – significant resources had already been expended in preparing the voluntary case in Delaware.
  - Fairness to creditors – retaining venue is Delaware would be in the best interest of all stakeholders.
- On June 13, 2019, White Star filed an amended motion seeking an order (1) authorizing the voluntary cases filed in Delaware to proceed; and (2) transferring the voluntary cases from Delaware to the Western District of Oklahoma.
  - White Star explained that the company's primary concern was proceeding with the chapter 11 cases in a venue that would efficiently facilitate a consensual financing and sale processes and maximize value. However, since filing the initial venue transfer motion, White Star discussed the venue issues with its key stakeholders and concluded that at this point in the cases, venue should be transferred to Oklahoma in order to keep the case timeline on track.
  - White Star specifically requested that the DIP financing and other first day relief that was granted by the Delaware court be preserved.
- On June 20, 2019, the Court entered an order transferring venue of the voluntary cases from Delaware to the Western District of Oklahoma.

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Case Study: Sherwin Alumina Company, LLC

- Filed in Southern District of Texas on January 11, 2016.
- In conjunction with filing its chapter 11 filing, Sherwin Alumina ("Sherwin") moved to assume a supply agreement that it had with Noranda Bauxite ("Noranda").
- On February 8, 2016, Noranda commended a chapter 11 case in the Eastern District of Missouri and moved to reject the Sherwin Alumina contract.
- On March 7, 2016, Sherwin Alumina file a motion to transfer Noranda's motion to reject its contract from the Eastern District of Missouri to the Southern District of Texas, Corpus Christi Division.
  - Sherwin argued that the transfer was justified by the need for consistency – the motions to assume and reject the contact should be decided by the same court. Additionally, Sherwin highlighted that the transfer would ensure uniformity and the efficient and economic use of both debtor and creditor resources.
- On March 14, 2016, Noranda filed an objection.
  - Noranda argued that transferring venue would splinter the administration of the estates between two courts, which would lead to extra time and higher costs for both parties. Additionally, Noranda argued that Sherwin's motion should be dismissed on procedural grounds because the motion allegedly did not conform to the local rules.

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Case Study: Sherwin Alumina Company, LLC

- On March 21, 2016 in advance of an April 1st hearing, Sherwin's legal counsel sent a letter to the Hon. Barry Schermer, who was presiding over the Noranda case in Missouri, requesting that the Judge Schermer invite Judge David Jones of the Southern District of Texas to participate in a joint hearing to adjudicate Noranda's motion to reject and Sherwin's motion to assume the supply agreement at issue.
  - Judge Schermer responded and noted his belief that a joint hearing would raise more issues that it would resolve and that a commercial resolution is the best path for both parties.
- On March 28, 2016, Sherwin filed a motion for coordination among the bankruptcy courts for the Southern District of Texas and the Eastern District of Missouri. Specifically, Sherwin requested that the Texas bankruptcy court (i) order Noranda to deliver certain shipments to Sherwin and (ii) approve the purchase price. Sherwin requested that the Missouri bankruptcy court schedule a hearing to review and approve a purchase price determined by the Texas bankruptcy court.
- On March 31, 2016, Sherwin sent a letter to Noranda suggesting two options to reach a consensual, commercial resolution regarding the disputed supply agreement.
- On April 1, 2016, the Missouri bankruptcy court heard arguments regarding the supply agreement. On April 7, 2019, Judge Schermer issued a memorandum of opinion explaining his order granting Noranda's motion to reject the supply agreement.
- Following the April 1st hearing in Missouri, on April 2, 2016, Sherwin withdrew its motion to dismiss the Noranda chapter 11 case and its venue transfer motion.

SHERWIN ALUMINA COMPANY, LLC

noranda™

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Background

- Sears is incorporated in Delaware and has its Principal Place of Business in Illinois, but in October, 2018 it filed for bankruptcy in the Southern District of New York.
- The decision was not surprising given that 80% of the largest bankruptcies between 2007 and 2013 were filed in New York or Delaware
- The decision not to file in Chicago was particularly predictable in the post *Kmart* era.

Criticism

- Critics argue that forum shopping permits companies to avoid scrutiny from employees, retirees, and the media.
- The appeal of New York and Delaware may mean that other jurisdictions are overlooked and miss out on the economic buzz that often accompanies large cases.

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Source: Claire Bushey, *Why Sears Filed for Bankruptcy in New York,* Crains New York Business, October 17, 2018.

PURDUE'S CHOICE OF NY BANKRUPTCY COURT PART OF COMMON FORUM SHOPPING STRATEGY, EXPERTS SAY

Background

- The September, 2019 filing of the Purdue Pharma bankruptcy brought venue back into the public spotlight.
- Purdue Pharma LP is incorporated in Delaware and has its Principal Place of Business in Connecticut, but it filed for bankruptcy in the Southern District of New York, White Plains.

Criticism

- Critics suggest that the venue was selected because the Court was more likely to approve a proposed settlement, which would halt about 25 ongoing lawsuits.
- Others have likened the move to "gerrymandering."
- Stay attorneys general have little power to request a venue change.
- Last year, Sens. Warren and Cornyn introduced legislation to address venue issues; however, the bill was never brought up for a vote.

Understanding

- Many see Purdue's choice of venue as a strategic choice.
- Bankruptcy Judge Drain, who will preside over the case, has significant experience with complicated cases and is generally known to be evenhanded and fair.

Source: Renae Merle and Lenny Bernstein, *Purdue's Choice of NY Bankruptcy Court Part of Common Forum Shopping Strategy, Experts Say*, Wash. Post, October 10, 2019.