Portfolio Media. Inc. | 860 Broadway, 6th Floor | New York, NY 10003 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Houghton Mifflin: Practically Proper Improper Venue

Law360, New York (August 21, 2012, 4:41 PM ET) -- Potential changes to bankruptcy venue laws have been much in the news recently, focusing on legislation now pending before Congress to amend those laws as they apply to corporate debtors. Against that backdrop, the U.S. Bankruptcy Court for the Southern District of New York issued a decision this summer that, while accepting the usual rules regarding where bankruptcy cases may be properly venued, offers important insight regarding parties' waivers of, or agreements with respect to, those rules.

In In re Houghton Mifflin Harcourt Publishing Company, Judge Gerber, in a decision highly critical of statutory law mandating dismissal or change of venue, granted the U.S. Trustee's unusual motion to transfer the venue of the debtors' Chapter 11 cases, notwithstanding that those cases were filed in New York pursuant to a prepackaged plan unanimously supported by the debtor's creditors. (Bankr. S.D.N.Y. June 22, 2012)

Transfer of Venue in Bankruptcy Cases

Venue for bankruptcy cases (other than Chapter 15 cases) is governed by 28 U.S.C. Section 1408 (Section 1408), which establishes five bases for venue in cases under the Bankruptcy Code. Under Section 1408, a debtor can properly commence a bankruptcy case in the district where (1) the debtor has a domicile (for a corporate debtor, its state of formation), (2) a residence, (3) its principal place of business, (4) its principal assets, or (5) where there is a pending bankruptcy case concerning the debtor's affiliate, general partner, or partnership.

Under the pending bankruptcy venue legislation (H.R. 2533), Section 1408 would be amended such that a Chapter 11 corporate debtor could file bankruptcy only where it has its principal place of business or principal assets, or where its affiliate has a pending Chapter 11 case, if that affiliate owns, controls, or holds more than 50 percent of the voting securities of the corporate debtor. The intended effect of the amendment is to curtail the filing of corporate bankruptcy cases in the "magnet" jurisdictions of New York and Delaware.

The Judicial Code contains two provisions governing changes in bankruptcy venue. First, under 28 U.S.C. Section 1412 (Section 1412), a district court may transfer the bankruptcy case to another district "in the interest of justice or for the convenience of the parties." This provision, under which transfer is within the discretion of the court, focuses on the broad concepts of justice and party convenience, but does not address cases in which venue is unsupportable under Section 1408. Accordingly, Section 1412 affords a discretionary basis for transferring the case, even if venue is supportable under Section 1408.

Second, under 28 U.S.C. Section 1406(a) (Section 1406), which under the majority view applies to cases under the Bankruptcy Code, if a case has been filed "in the wrong division or district," the district court shall "dismiss, or if it be in the interest of justice, transfer such case to any district or division in which it could have been brought." In contrast to Section 1412, the standard for transfer of a case under Section 1406 is very specific: the venue cannot meet the standards in Section 1408. Moreover, if that is the case, dismissal or transfer is mandatory, rather than discretionary.

At the same time, courts have been clear that venue is not jurisdictional and does not affect a court's power to render judgment. The jurisdiction of federal courts is a grant of authority to them by Congress, one that is based on constitutional considerations. "[T]he locality of a law suit — the place where judicial authority may be exercised — though defined by legislation relates to the convenience of litigants ..." Neirbo Co. v. Bethlehem Shipbuilding Corp., 308 U.S. 165, 168 (1939). Accordingly, unlike jurisdiction, parties can waive venue requirements.

In re Houghton Mifflin

In Houghton Mifflin, a case in which nearly all parties in interest were agreeable to the case being heard in New York, regardless of the venue rules, Judge Gerber of the U.S. Bankruptcy Court for the Southern District of New York reluctantly granted the U.S. Trustee's motion under Section 1406 to transfer venue, saying that his "hands [were] tied" by statutory law.

Saddled with excessive debt and faced with low demand for its grade school textbooks, Houghton Mifflin Harcourt Publishing Company (Publishing), a Delaware corporation and the debtors' primary operating company, and its indirect parent, Houghton Mifflin Holding Company (Holdco), also a Delaware corporation, and over 20 affiliates (the debtors) filed for Chapter 11 bankruptcy protection on May 21, 2012, with a prepackaged plan of reorganization in place that had been unanimously accepted by the debtors' creditors.

Notably, the debtors' plan support agreement with its secured creditors required the cases to be filed in the Southern District of New York. With the confirmation hearing scheduled, the U.S. Trustee moved to transfer the debtors' cases, arguing that transfer or dismissal was mandatory, under Section 1406, because venue in the Southern District of New York was not proper under Section 1408. After denying the U.S. Trustee's request to have its motion heard on shortened notice, the court confirmed the plan prior to issuing a decision on the motion.

Before addressing the merits, Judge Gerber paused to note that the U.S. Trustee's motion was "perplexing," since the choice of venue, the Southern District of New York, was exactly what the creditors wanted and since venue concerns can be waived by creditors and the U.S. Trustee alike. Nevertheless, the court continued with an analysis of the relevant statutory laws that it ultimately held required the motion to be granted.

The Mandate of 28 U.S.C. Section 1406

The first part of the court's analysis was devoted to the statutory provisions relevant to the U.S. Trustee's motion. After taking note of the five bases for venue laid out in Section 1408 and its discretionary power under Section 1412 to transfer a bankruptcy case "in the interest of justice or for the convenience of the parties," the court turned to Section 1406, the basis of the U.S. Trustee's motion.

In accordance with the majority view, which other judges in the Southern District of New York had espoused, the court concluded that Section 1406 applies to cases under the Bankruptcy Code to mandate dismissal or transfer of the case where the requirements of Section 1408 have not been satisfied, where those requirements have not been waived, and where a party with standing has made a timely objection to venue.

The court, however, logged its concern that the majority rule, positing that the court lacks authority to retain a case in that scenario, may not square with the nature of venue, which is not jurisdictional and can be easily waived.

From a practical standpoint, the court lamented that Section 1406 precludes courts from retaining cases where "creditor convenience, avoiding unnecessary expense, and the interests of justice" warrant it, but where "a gadfly or an entity with a private or political agenda" objects to the venue. Having concluded that Section 1406 applies to cases under the Bankruptcy Code and determined the statute's effect, the court turned to the question of whether the mandate of Section 1406 was triggered in the Debtors' cases.

The Propriety of Venue Under 28 U.S.C. Section 1408

The court was unable to find that any of the venue bases in Section 1408 had been satisfied such that the mandate of Section 1406 could be avoided. The debtors had asserted that venue in New York was proper for Publishing and Holdco and, therefore, for all of their debtor affiliates under the fifth venue basis of Section 1408, which permits a debtor to "bootstrap" its own venue to the proper venue of an affiliate. But neither Publishing nor Holdco satisfied any of the first four venue bases, eliminating the debtors' argument for the remaining debtor affiliates.

First, the court considered the debtors' venue contentions in respect of Publishing. Given that Publishing, a Delaware corporation, was domiciled in Delaware and that its principal place of business and principal assets were in Massachusetts, the debtors' sole argument was that Publishing had a "residence" in New York. While accepting the proposition that Publishing, which had leased premises and employees in Manhattan, did business in New York, the court quickly rejected the idea that "residence," as a basis for venue, could apply to a business entity, instead concluding that only a natural person could have a "residence."

Second, the court considered whether Holdco could support venue in New York under one of the first four venue bases. The debtors had made clear that their venue contentions with respect to Holdco, a Delaware corporation, were based on its purportedly having its principal assets in New York, such assets consisting of leased and subleased space in New York City. The court, however, rejected the argument that the lease, which was a net cash drain, and the sublease were Holdco's principal assets, considering, among other things, the fact that Holdco held the stock of 15 subsidiaries, one of which (Publishing) had assets worth more than a billion dollars.

Delayed Venue Transfer

The court therefore ordered the venue transfer mandated by Section 1406. Noting, however, that Section 1406 does not impose a timetable for any required dismissal or transfer, the court, in an effort to "[minimize] ... the harm to the creditors and other stakeholders that [the] motion engendered," delayed the transfer until the first to occur of the effective date of the debtors' prepackaged, confirmed plan or three weeks from the date of entry of the confirmation order.

Additionally, the court opted not to stay the effective date of the plan based on the U.S. Trustee's venue concerns, again emphasizing that "[v]enue objections, even if valid, are not jurisdictional." The court left open the question of where the case would be transferred.

The Case in Context

In Houghton Mifflin, the clear premise underlying Judge Gerber's approach to the U.S. Trustee's venue transfer motion was that because venue is not jurisdictional, the court has authority to hear the case even if venue is improper under Section 1408, if the parties waive venue. Judge Gerber was obviously concerned by the U.S. Trustee's motion insofar as it contravened the parties' unanimous wavier of venue, which would have allowed the court to keep the case in New York for considerations of party convenience, cost-savings, and efficiency.

From a practical perspective, the implication of Houghton Mifflin in this regard is that a debtor, subject to the discretion of the court, can effectively forum shop and have its bankruptcy case heard in the improper venue of its choice, so long as it has the agreement of its creditors or at least so long as no party in interest objects. Nothing about the pending venue legislation, which would only amend Section 1408's standards for proper venue in Chapter 11 cases, would change this.

Addressing the actual situation at hand, one in which all parties had not waived venue, Judge Gerber asked an important question in respect of his authority to retain the case: If venue is not jurisdictional, then why should the objection of one party — even a "gadfly," in Judge Gerber's own words — deprive the court of authority to hear the case? On the unusual facts of Houghton Mifflin, that question seems compelling. In the context of the U.S. Trustee's motion to transfer venue, which cut against the will of the debtors' creditors, the effect of Section 1406 was perverted, mandating transfer even where it would be more expensive and less convenient for the debtors' creditors.

In another case, however, the role of the U.S. Trustee as objector to the improper venue could just as easily be filled by a lone creditor — perhaps a trade creditor — who is genuinely inconvenienced by the improper forum that, for whatever reason, is agreeable to other parties in interest and who in good faith seeks to enforce the limits of Section 1408.

From the perspective of that creditor, Section 1406, which mandates dismissal or transfer merely upon that creditor raising its hand, offers a level of comfort that the creditor will be able to access the bankruptcy proceedings in a district that Congress itself has determined to be proper. Time will tell whether Congress will enact the now pending bankruptcy venue legislation and revise its prior conclusions regarding where corporate bankruptcy cases are properly venued.

--By John F. Ventola, Douglas R. Gooding and Meg McKenzie Feist, Choate Hall & Stewart LLP

John Ventola is a partner in the finance & restructuring group at Choate Hall & Stewart in Boston. Douglas Gooding is the chairman of Choate's finance & restructuring group in Boston and Meg McKenzie Feist is an associate in the group in Boston.