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Section 363 Sales: Good Practices, and Pitfalls to Avoid

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Section 363 Sales – Good Practices and Pitfalls to Avoid

The Shifting Sands of Real Covenants

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Introduction

The burst of bankruptcy filings at the beginning of the COVID-19 pandemic gave courts across the country reason to consider how covenants running with the land can be addressed in bankruptcy and, more specifically, under section 363(f) and other provisions of the Bankruptcy Code. These recent decisions suggest that debtors are increasingly attempting to extinguish covenants running with the land, and that counterparties must be prepared to confront such challenges. Bidders in a section 363 process are often required to predict how a court might rule on a potential dispute and value their bid accordingly. Regardless of one's role in the process, and contrary to their name, real covenants are not always solid ground.

The Basics – Section 363(f)

Section 363(f) of the Bankruptcy Code provides:

> The trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if—
>
> **(1)** applicable nonbankruptcy law permits sale of such property free and clear of such interest;
>
> **(2)** such entity consents;
>
> **(3)** such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
>
> **(4)** such interest is in bona fide dispute; or

> **(5)** such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.[1]

Drafted in the disjunctive, section 363(f) requires that the debtor satisfy only one of the five conditions in order to complete a free and clear sale.

The question of what constitutes an "interest" in property that can be extinguished or set aside in a section 363 sale is not always straightforward. The Bankruptcy Code does not define the term "interest." Although plainly encompassing liens, claims arising from property, or other "obligations that are connected to, or arise from, the property being sold," there appears to be a trend toward a more expansive reading of the term.[2] If a claimant's rights arise in some manner from the fact that the subject property has been used, such claim constitutes an "interest" subject to section 363(f).[3]

Given the sometimes fact-specific application of the term, parties with potential "interests" must be vigilant in protecting their rights during a section 363 sale process, as a recent Fifth Circuit opinion illustrates. In *Sherwin Pipeline, Inc. v. Sherwin Alumina Co., LLC (In re: Sherwin Alumina Co., LLC)*, the debtor sought to confirm a plan that provided for a free and clear sale of property burdened by an access easement.[4] The proposed confirmation order provided that the property would be transferred free and clear of all "encumbrances," but subject to permitted encumbrances.[5] The order did not specifically mention the subject easement.[6] A month after confirmation, an assignee of the buyer informed the easement holder the easement was

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1 11 U.S.C. § 363(f).

2 *In re TWA*, 322 F.3d 283, 289 (3d Cir. 2003); *see also Elliott v. General Motors LLC* (*In re Matt*er *of Motors Liquidation Co.)*, 829 F.3d 135, 155 (2d Cir. 2016).

3 *UMWA 1992 Benefit Plan v. Leckie Smokeless Coal Co (In re Leckie Smokeless Coal Co.)*, 99 F.3d 573, 582 (4th Cir. 1996)

4 952 F.3d 229, 232 (5th Cir. 2020).

5 *Id.*

6 *Id.*

extinguished by virtue of the sale.[7] The easement holder sought to collaterally attack the confirmation order through an adversary proceeding, arguing that it had no notice that the confirmation order would extinguish the easement and that certain last minute changes to the confirmation order affecting the easement amounted to fraud and denial of due process.[8] Though the easement holder's due process claim survived a motion to dismiss, the fraud claim did not.[9] The Fifth Circuit reasoned that the easement was always an "encumbrance" and the plan and confirmation order always contemplated that the property would be sold free and clear of all encumbrances (even if the subject easement was not expressly mentioned).[10] Thus, any "last-minute" modifications "were not changes at all with resect to the Port's easement."[11]

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[7] *Id.* at 232-33.

[8] *Id.*

[9] *Id.*

[10] *Id.* at 236.

[11] *Id.* The dissent from the denial of *en banc* reconsideration expressed concerns about the process of finalizing the confirmation order, critical of many practices that may seem commonplace to many practitioners:

> Contrary to the bankruptcy court's wholesome openmindedness, the panel opinion repeatedly implies that the Port could have/should have known the debtor's intentions to "extinguish" its easement, which the debtor allegedly swept into its documentation under the generic term "encumbrance." Although the facts have not been fully vetted, the Port's pleadings suggest quite a different story. No less than ten lengthy draft documents required for a proposed sale of the debtor's property were filed in the bankruptcy court over a period of months. Several of these described "Acquired Real Property" as including Easements, "other than the Excluded Properties." Excluded Assets, the debtor represented, was an undefined category that would be identified in a later schedule. The panel opinion states that "[n]one of these [transactional documents] suggested that the Port's easement would be a permitted encumbrance," i.e., an interest that would run with the land in an eventual sale. More precisely, however, never prior to the eve of confirmation was the schedule supplied, nor did any of the transactional documents reference the Port's easement directly or indirectly.
>
> After midnight preceding the confirmation hearing, the debtor filed a proposed 334-page confirmation order. At paragraph 108, the debtor at last defined "permitted encumbrances" to include a number of specific servitudes as well as "easements or encumbrances...recorded prior to July 1, 2009." This vague definition excluded the Port's easement, and only that easement, from "encumbrances" that would survive the sale of the debtor's real property. As the panel opinion acknowledges, this definition was neither highlighted nor otherwise identified, and the debtor's counsel represented in court the next day that he did not believe any material modifications had been made to the plan of reorganization. But the panel opinion says the Port is "inaccurate" "to allege that Sherwin's last-minute changes for the first time 'stripp[ed] third party easement property rights" from its land.

When Real Covenants Meet Section 363(f)

Recent decisions suggest at least two possible approaches when a debtor invokes section 363(f) to attempt to sell property free and clear of a covenant running with the land. Both approaches and other recent decisions, however, arose in oil and gas cases and involved alleged real covenants in midstream distribution contracts. Although instructive, it is uncertain how the reasoning of such decisions would apply in other contexts.

In re Southland Royalty Co. LLC

The debtor, an oil and gas exploration and production company, commenced a chapter 11 proceeding to sell its assets.[12] The debtor's sale process failed to draw sufficient interest because, according to the debtor, the assets were encumbered by a burdensome gas gathering agreement, which purported to run with the land and burdened the assets with a minimum volume commitment and deficiency fees.[13] The debtor filed an adversary proceeding seeking to determine, among other things, whether it could sell its assets free and clear of the gas gathering agreement section 363(f)(1), (4), & (5).[14]

For purposes of its analysis the court assumed that the gas gathering agreement was a real covenant.[15] The court confirmed that a real covenant such as the gas gathering agreement was an

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Id. at 236-38 (Jones, J., dissenting).

12 *Southland Royalty Co. LLC v. Wamsutter LLC (In re Southland Royalty Co. LLC)*, 623 B.R. 64, 70 (Bankr. D. Del. 2020).

13 *Id.*

14 *Id.* As noted below, the debtor also sought and obtained a determination that the gathering agreement did not run with the land under Wyoming law and, regardless, was an executory contract subject to rejection under 11 U.S.C. § 365. Such issues gained national prominence in a series of decisions arising out of the Sabine Oil & Gas Corp. bankruptcy. *See Sabine Oil & Gas Corp. v. HPIP Gonzales Holdings, LLC (In re Sabine Oil & Gas Corp.)* ("*Sabine I*"), 550 B.R. 59 (Bankr. S.D.N.Y. 2016), *aff'd*, 567 B.R. 869 (S.D.N.Y. 2017) ("*Sabine II*"), *aff'd sub nom. Sabine Oil & Gas Corp. v. Nordheim Eagle Ford Gathering, LLC (In re Sabine Oil & Gas Corp.)*, 734 F. App'x. 64 (2d Cir. 2018).

15 *Id.* at 96.

"interest" that could be extinguished under section 363(f) – the only question was whether the debtor could satisfy any of the five conditions.[16] As to section 363(f)(1):

> Wyoming law allows a preexisting mortgage with priority over a later-created real property covenant to extinguish the covenant through foreclosure. The purpose is to protect the mortgagee by ensuring that upon foreclosure, the mortgagee acquires exactly such title as the mortgagor owned at the time the mortgage was executed. Wamsutter does not dispute Wyoming state law on this matter or the priority of the RBL Lenders' credit facilities or their foreclosure rights. Rather, it argues that section 363(f)(1) does not permit Southland to stand in the shoes of the RBL Lenders and exercise their foreclosure rights. It contends that section 363(f)(1) applies only to situations where the owner of the asset may, under non-bankruptcy law, sell the asset free and clear. However, section 363(f)(1) creates no such limitations. Its language is clear that Southland may sell property free and clear of any interest in such property held by a non-debtor "if applicable nonbankruptcy law" permits a sale free and clear.[17]

As to section 363(f)(5):

> Under Wyoming law, ["i]t is well established that both legal and equitable remedies are available in covenant enforcement actions[.] 'Valid covenants, like other contracts and property interests, can be enforced and protected by both legal and equitable remedies as appropriate, without regard to the form of the transaction.'" As explained by the *Restatement (Third) of Property: Servitudes*, courts have wide discretion to select an appropriate remedy to provide full and appropriate relief to an injured party and, in doing so, may consider the nature and purpose of the servitude as well as the transaction that created it. Importantly, the L63 Agreement does not limit the remedies available in the event of a breach or exclude monetary damages. Moreover, given that a purpose of the L63 Dedication is to ensure the proper compensation of Wamsutter by way of the fees provided for in the L63 Agreement, monetary damages are an appropriate, calculable remedy.[18]

Clearly, the nature of the real covenant at issue was key to the court's analysis.

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16 *Id.* at 97 (citing *Newco Energy v. Energytec, Inc. (In re Energytec)*, 739 F.3d 215, 225-26 (5th Cir. 2013)).

17 *Id.* at 97-98.

18 *Id.* at 98-99.

In re Badlands Energy, Inc.

The debtor, an oil and gas exploration and production company, filed for chapter 11 protection and pursued a section 363 sale of its assets.[19] As with many such companies, its assets were purportedly burdened by midstream gas gathering/processing and saltwater disposal agreements (collectively, the "Midstream Agreements").[20] The purchaser sought to buy the assets without assuming any of the Midstream Agreements and free and clear of any obligations thereunder.[21] Shortly before the sale hearing, Monarch Midstream, LLC ("Monarch") filed an adversary proceeding seeking a declaratory judgment that the Midstream Agreements contained covenants running with the land that could not be extinguished pursuant to section 363(f).[22]

Applying Utah law, the court concluded that the covenants contained in certain of the Midstream Agreements were covenants running with the land.[23] Turning to section 363(f), the court ruled that restrictions that run with the land *are not* "interests" that can be extinguished under section 363(f):

> Restrictions that run with the land "create equitable interests that do not compel a person to accept a monetary interest; thus, when restrictive covenants are involved, there is nothing that can force those who benefit from restrictive covenants to forego [sic] equitable relief in favor of a cash award."[24]

Even if the covenants were "interests," the court concluded that Utah law would not permit the sale of property free and clear of the covenants under section 363(f)(1) and Monarch could not be

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19 *Monarch Midstream, LLC v. Badlands Prod. Co. (In re Badlands Energy, Inc.)*, 608 B.R. 854, 860 (Bankr. D. Colo. 2019).
20 *Id.*
21 *Id.* at 863.
22 *Id.*
23 *Id.* at 874.
24 *Id.* at 874-75 (quoting *In re Lonesome Pine Holdings, LLC*, 2011 Bankr. LEXIS 5775 (Bankr. D. Colo. Sept. 1, 2011)).

compelled under section 363(f)(5) to accept monetary satisfaction of the covenants.[25] In sum, "the Agreements are part of the bundle of sticks Wapiti Utah acquired when it purchased the Riverbend Assets, and they are not subject to elimination utilizing Section 363(f)."[26]

A Potential Workaround

Invoking section 363(f) may not be the only means by which a debtor can address liabilities associated with real covenants. Though the *Badlands* court concluded that real covenants could not be rejected under section 365, it also declined to hold the purchaser liable for any of the debtor's pre-closing liabilities.[27] More recent decisions from other jurisdictions have gone further, finding that executory contracts containing covenants running with the land can be rejected.[28] Addressing the question of what happens to a covenant running with the land that has been rejected, one court explained:

> The answer is simple: any covenant running with the land still exists (as the contract still exists), but it is unenforceable against the Debtors and their assigns after the Rejection Counterparties' claims are satisfied as part of the reorganization process. Upon rejection, the Rejection Counterparties' claims under the TSAs will be compensated, rendering the claims fully satisfied and incapable of subsequent enforcement against the Debtors and its assigns through either privity of contract or privity of estate. Importantly, the Rejection Counterparties cannot seek duplicative recovery for the breached covenants by using privity of estate as justification for suing successors to the Debtors' real property interests for a breach of the fully satisfied covenants.[29]

Other courts have followed such reasoning.[30]

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[25] *Id.* at 875.

[26] *Id.* at 874.

[27] *Id.* at 875.

[28] *See In re Southland*, 623 B.R. at 70.

[29] *In re Extraction Oil & Gas*, 622 B.R. 608, 623 (Bankr. D. Del. 2020).

[30] *Occidental Petro. Corp. v. Sanchez Energy Corp. (In re Sanchez Energy Corp.)*, 631 B.R. 847, 860 (Bankr. S.D. Tex. 2021) ("[T]he presence of a real property covenant does not hinder a debtor's right to reject its future performance duties under an executory contract. Nothing prevents a contract from forming a real property covenant while still being executory (having material performance remaining on both sides). Congress granted debtors the expansive right to reject *any* executory contract. 11 U.S.C. § 365(a). The existence of a real property covenant does

Conclusion

Notably, the most prominent recent decisions regarding real covenants and section 363(f) arose in the same context: midstream oil and gas executory contracts. Unlike other types of real covenants, damages for breach of such contracts are generally readily ascertainable. It is, at best, uncertain whether the reasoning applicable to midstream contracts would apply with equal force to other, more traditional types of real covenants. Nevertheless, debtors, counterparties, and buyers in sales involving an alleged covenant running with the land would be well served to fully understand the current landscape before embarking on, objecting to, or participating in any section 363 sale process.

not limit the rejection power that Congress granted to debtors. If a contract is executory, a debtor may seek rejection." (citation omitted)).

VENUE CONSIDERATIONS AND RECENT DEVELOPMENTS

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I. INTRODUCTION

Choice of venue can be a significant decision for would-be commercial debtors, particularly those with viable, ongoing business operations. This significance may increase for those debtors contemplating a sale(s) of assets/operations under 11 U.S.C. § 363 as part of their bankruptcy strategy. Notably, however, venue choice for sale cases is less of a factor than it was in the past, when many courts denied approval of such sales as impermissible *sub rosa* plans. *See*, *e.g.*, *Pension Benefit Guaranty Corp. v. Braniff Airways, Inc*., 700 F.2d 935, 939-40 (5th Cir. 1983); *Committee of Equity Security Holders v. Lionel Corp.*, 722 F.2d 1063, 1070-71 (2d Cir. 1991). Today, few courts currently apply this doctrine to deny § 363 sale motions.

Venue has been a hot topic for decades, and continues to be the subject of cases, articles, rule changes, and proposed legislation. For now, the status quo continues: (i) debtors may choose their venue based on parameters that are well-established in federal courts, and their choice is entitled to deference; and (ii) parties-in-interest may challenge a debtor's choice of venue.

II. VENUE BASICS

Venue is proper for a bankruptcy case in any judicial district in which the debtor's "domicile, residence, principal place of business . . . or principal assets" have been located for the 180 day period prior to the petition date, or "a longer portion" of that 180 day period than the domicile, residence, principle place of business, or assets "of such person were located in any other district." 28 U.S.C. § 1408(1). Venue is also proper in the district where there is a pending bankruptcy case of the debtor's affiliate, general partner, or partnership. 11 U.S.C. § 1408(2).

Even if venue is proper, a court may transfer venue to another district "in the interest of justice or for the convenience of the parties." 28 U.S.C. § 1412. In determining whether to transfer venue, courts may apply a number of factors, including:

- The proximity of creditors to the court;
- The proximity of the debtor to the court;
- The proximity of the witnesses necessary to the administration of the estate;
- The location of the estate's assets;
- The economical administration of the estate; and
- The necessity for ancillary administration if liquidation should result.

1 COLLIERS ON BANKRUPTCY ¶ 4.05[3][a][ii] (Richard Levin & Henry J. Sommer eds., 16th ed.). Deference is given to a debtor's choice of forum. *See*, *e.g.*, *In re Enron Corp.*, 274 B.R. 327, 342 (Bankr. S.D.N.Y. 2002).

III. VENUE CHOICE CONSIDERATIONS

Different courts and jurisdictions handle sales under 11 U.S.C. § 363 differently, and counsel must consider the implications of those differences to the extent that their client has the option to file in more than one venue.

Factors that debtors may consider include a jurisdiction's experience with asset sales, the speed at which a court has been willing to approve them, the allowance of credit bidding, local rules, the jurisprudence of sitting judges, and existing precedent. Some would-be debtors may have multiple venue choices, *e.g.* where their principal place of business is in one jurisdiction, and their state of incorporation is in another.

Currently, popular choices for mega-chapter 11 cases are:

- Southern District of Texas
  - "Complex Chapter 11 Cases" are assigned to one of two judges
  - *e.g.*, Highland Capital Management, L.P.
- Southern District of New York
  - Decades of mega-case precedent
  - *e.g.*, Purdue Pharma LP
- Eastern District of Virginia
  - Two-Judge Court
  - *e.g.*, Toys R Us, Inc.
- District of Delaware
  - Decades of mega-case precedent
  - *e.g.*, Boy Scouts of America, Inc.

Of course, judges, local rules, and jurisdictional precedent can change, potentially altering venue dynamics. For instance, Bankruptcy Judges Christopher Sontchi (D. Del.), Robert Drain (S.D.N.Y.), and Shelly Chapman (S.D.N.Y.), all of whom have presided over significant mega cases, have all announced their retirement effective June, 2022.

IV. CASES

A. *Casa Bonita* (*In re Summit Family Restaurants, Inc.*) Case No. 21-02477 (Bankr. D. Ariz.)

Casa Bonita is a nationally known, single-site restaurant and entertainment center located in Lakewood, Colorado. The restaurant ceased operations as a result of the COVID 19 pandemic in September, 2020, and filed its sub-chapter V petition in the District of Arizona in April, 2021 to stay a state court unlawful detainer action filed by its landlord.

Within three weeks of the petition date, the landlord filed a motion to transfer venue to the District of Colorado. The landlord argued that the Debtor's sole business operation, all of its assets, and the vast majority of its creditors were in Colorado.

In its response, the Debtor argued that venue was proper because its sole director, who "controls and directs all of the Debtor's activities" was in Arizona. The Debtor further argued that transfer of venue would result in inefficiency, additional cost, delay and disruption. Finally, the Debtor argued that transfer was unnecessary because Zoom and telephonic appearance capabilities made transfer unnecessary.

After a hearing on the motion, the Court transferred the case to the District of Colorado.[1]

Epilogue: After the case was transferred to Colorado, the Debtor filed a motion to approve a private sale of the restaurant to the creators of *South Park*. That motion was approved over the objection of "Save Casa Bonita," a local group of restaurateurs, who offered to pay $400,000 more than the proposed buyer. A Plan was subsequently confirmed.

[1] Case No. 21-13328.

B. *In re Highland Capital Management, L.P.*
Case No. 19-12239 (Bankr. D. Del.)

Highland filed a voluntary chapter 11 petition in the District of Delaware on October 18, 2019. The Debtor's principal place of business, which also served as its international headquarters and only office in the United States, was located in Dallas, Texas. On November 1, 2019, the Official Committee of Unsecured Creditors filed a motion to transfer venue to the Northern District of Texas.

The Delaware Court granted the motion based primarily on two factors:

- The Debtor's executives/management and principal place of business were located in Dallas, Texas.
- Existing litigation with a debtor-affiliate had been pending in Dallas, Texas for an extended period of time.

Transcript of Record at 105-10, *In re Highland Capital Management, L.P.*, Case No. 19-12239 (CSS) (Bankr. D. Del. Dec. 3, 2019). Judge Sontchi made several interesting observations during his ruling:

- Much of the case law cited by the parties "[did] not reflect the modern reality of Chapter 11 practice in the U.S. and internationally."
- He disagreed with "the idea that there is somehow a strong [in favor of] presumption of the debtor's choice of forum."
- Every sophisticated chapter 11 debtor engages in forum shopping.
- Creditors that seek venue transfer "are engaged in forum shopping as well."
- The term "forum shopping" should not have a negative connotation. "It is the reality of bankruptcy practice."

Id.

C. "Texas Two-Step"

The "Texas Two-Step" is a mechanism whereby a debtor's predecessor undergoes a Texas divisive merger, creating the debtor, immediately after which the debtor's state of incorporation is converted to the jurisdiction in which the debtor wants to file its bankruptcy case. *In re LTL Management LLC*, Case No. 21-30589 (Bankr. W.D.N.C., November 16, 2021) Order at 9 [D.I. 416] ("Order"). The purpose of the strategy is apparent: transfer liabilities from a viable OpCo into a newly created affiliate, and subsequently put the liability-laden affiliate into bankruptcy in a favorable venue.[2]

1. *In Re: LTL Management LLC*.

Shortly before filing its case, the Debtor, LTL, was created through a corporate restructuring.

> "The former Johnson & Johnson Consumer Inc. ("Old JJCI"), a subsidiary of Johnson & Johnson ("J&J"), ceased to exist and two new corporate entities were created. The first was Debtor LTL, which initially was formed as a Texas limited liability company, and then converted into a North Carolina limited liability company. The second entity was also initially formed as a Texas limited liability company, but then it was merged into J&J and changed its name to Johnson & Johnson Consumer Inc. ("New JJCI"). The Debtor said the purpose of this restructuring was to fully resolve talc-related claims through a chapter 11 reorganization without subjecting the entire J&J enterprise to a bankruptcy proceeding."

Order at 1. Venue was proper for LTL in North Carolina, but it was quickly challenged by the Bankruptcy Administrator and others who sought to transfer venue to New Jersey.

The movants argued that, while venue was proper, it was "manufactured." They alleged that all of LTL's operations were in New Jersey (with none in North Carolina), and that New Jersey

[2] The Texas Two-Step was discussed in the article by Jeffrey R. Gleit and Matthew R. Bentley, *When the Music Stops: The Texas Two-Step and Forecasting Its Future Application*, ABI JOURNAL, Dec. 2021, at 12.

was also the venue of the pending federal multi-district litigation (MDL) in which the Debtor and its primary liabilities were involved.

The Debtor argued that the North Carolina Court had developed substantial expertise in mass tort and divisional merger bankruptcy cases that was applicable to its case. The Debtor also argued that LTL was a "national case," unlike the "local cases" that are more appropriately transferred.

Ultimately, Judge Whitley transferred the case to the District of New Jersey "in the interest of justice" and to "promote an effective administration of the estate, fairness, and judicial economy." Order at 11. In his decision, Judge Whitley made several notable statements:

- Four similar bankruptcy cases were pending in his district, each of which "used the 'Texas Two-Step' to create a North Carolina entity with limited assets and all or most of its predecessors' asbestos liability, and the North Carolina entity filed for bankruptcy in this district shortly after its creation." Order at 10.
- "[T] he Debtor is not just forum shopping; the Debtor is manufacturing forum and creating a venue to file bankruptcy." Order at 10.
- "[T]he Texas Two-Step tactic is being employed by national corporations and impacts tens of thousands of present and future claimants across the country." Order at 11.

2. *Boy Scouts of America, Inc.*
Case No. 20-10343 (Bankr. D. Del.)

Prior to filing, Boy Scouts of America, Inc. ("BSA") implemented a version of the Texas Two-Step to create venue in the District of Delaware. BSA was a federally chartered organization with its headquarters in Texas. Less than a year before filing, BSA created a Delaware subsidiary, Delaware BSA, LLC. Delaware BSA LLC filed its chapter 11 petition in Delaware in February,

2020, and BSA filed immediately thereafter. However, no one challenged venue in the BSA case, and it remains pending in the District of Delaware. *See*, *Boy Scouts of America: Venue Demerit Badge*, http://www.abi.org/feed-item/boy-scounts-of-america%C2%A0-venue=demerit-badge (last visited Nov. 22, 2021).

V. RECENT AND PROPOSED CHANGES

A. Modification in Assignment of Mega Chapter 11 Cases in the Southern District of New York

Effective as of December 1, 2021, the Local Rules of the Southern District of New York were amended so that "Mega Chapter 11 Cases" will be assigned to bankruptcy judges in that district on a random basis, irrespective of the courthouse in which the case is filed. Previously, all cases were assigned to a judge in the courthouse in which the case was filed. Because the White Plains and Poughkeepsie courthouses each have one sitting bankruptcy judge, cases filed in those courthouses were assigned to the respective sitting judge.

The text of new Local Bankruptcy Rule 1073-1 (f) is as follows:

> (f) Mega Chapter 11 Cases. Notwithstanding subdivision (a) of this rule, the Clerk shall assign a mega chapter 11 case to a Judge in the District by random selection irrespective of the courthouse in which the case is filed. A chapter 11 case qualifies as a mega chapter 11 case if the assets or liabilities of the debtor are equal to or greater than $100 million. A multi-debtor chapter 11 case qualifies as a mega chapter 11 case if the cumulative assets or cumulative liabilities of the filing debtors are equal to or greater than $100 million.

The Press Release issued by the Southern District of New York said that this change "will result in a more balanced utilization of judicial resources." Commentators opine that the change was driven by controversy over alleged forum shopping within that District.

B. Pending – The Bankruptcy Venue Reform Act of 2021

The Bankruptcy Venue Reform Act of 2021 ("Act") proposes to substantively amend 28 U.S.C. §§ 1408 (Venue of cases under title 11) and 1412 (Change of venue). The expressly-stated purpose of the Act is "to prevent the practice of forum shopping in cases filed under chapter 11 of title 11, United States Code."

The Act (H.R. 4193) was introduced in the House in June, 2021, and a companion bill (S.2827) was introduced in the Senate in September, 2021. As of December, 2021, no other action has been taken.

Highlights of the Act's proposed venue choice restrictions are:

- For non-individual filers, the place of domicile is no longer a basis for proper venue.
- Non-individual filers must file in jurisdiction of "the principle place of business or principle assets in the United States."
- For entities that are subject to reporting under the Securities & Exchange Act of 1934, the "principle place of business" is "the address of the principle executive office as stated in the last annual report," unless another address is demonstrated by clear and convincing evidence.
- Cash and cash equivalents are excluded from consideration for purposes of determining the location of a non-individual debtor's "principle assets."
- Filing in the jurisdiction of a pending affiliate case is still a viable venue choice, but the affiliate must be a GP or a majority shareholder (an affiliate that owns, controls, or holds 50% or more of the outstanding voting securities of, or is the general partner of the second-to-be-filed entity).

- With respect to a filing entity or its affiliate, no effect will be given to a change in ownership or control, or to the transfer of the principal place of business/assets, if made within one year prior to the petition date, or for the purpose of establishing venue.
- Courts must "immediately" dismiss or transfer cases filed in an improper venue.
- When considering a venue transfer motion, courts may still evaluate the interest of justice and the convenience of the parties, but:
    - a debtor's choice of forum is no longer entitled to deference.
    - if there is a challenge to the choice of venue, the debtor must defend its choice by establishing proper venue with "clear and convincing" evidence.
    - courts must rule on a venue motion/objection within 14 days of the filing of the motion/objection.

The text of the proposed new statutes is attached as Annex A.

ANNEX A

Text of §§ 1408 and 1412 as Proposed By the Bankruptcy Venue Reform Act of 2021

§ 1408. Venue of cases under title 11

(a) PRINCIPAL PLACE OF BUSINESS WITH RESPECT TO CERTAIN ENTITIES.—

(1) IN GENERAL.—Except as provided in paragraph (2), for the purposes of this section, if an entity is subject to the reporting requirements of section 13 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m, 78o(d)), the term 'principal place of business', with respect to the entity, means the address of the principal executive office of the entity as stated in the last annual report filed under that Act before the commencement of a case under title 11 of which the entity is the subject.

(2) EXCEPTION.—With respect to an entity described in paragraph (1), the definition of the 'principal place of business' under that paragraph shall apply for purposes of this section unless another address is shown to be the principal place of business of the entity by clear and convincing evidence.

(b) VENUE. —Except as provided in section 1410, a case under title 11 may be commenced only in the district court for the district—

(1) in which the domicile, residence, or principal assets in the United States of an individual who is the subject of the case have been located—

(A) for the 180 days immediately preceding such commencement; or

(B) for a longer portion of the 180-day period immediately preceding such commencement than the domicile, residence, or principal assets in the United States of the individual were located in any other district;

(2) in which the principal place of business or principal assets in the United States of an entity, other than an individual, that is the subject of the case have been located—

(A) for the 180 days immediately preceding such commencement; or

(B) for a longer portion of the 180-day period immediately preceding such commencement than the principal place of business or principal assets in the United States of the entity were located in any other district; or

(3) in which there is pending a case under title 11 concerning an affiliate that directly or indirectly owns, controls, or holds 50 percent or more of the outstanding voting securities of, or is the general partner

of, the entity that is the subject of the later filed case, but only if the pending case was properly filed in that district in accordance with this section.

(c) LIMITATIONS.—

(1) IN GENERAL.—For the purposes of paragraphs (2) and (3) of subsection (b), no effect shall be given to a change in the ownership or control of an entity that is the subject of the case, or of an affiliate of the entity, or to a transfer of the principal place of business or principal assets in the United States of an entity that is the subject of the case, or of an affiliate of the person entity, to another district, that takes place—

(A) within 1 year before the date on which the case is commenced; or

(B) for the purpose of establishing venue.

(2) PRINCIPAL ASSETS.—

(A) PRINCIPAL ASSETS OF AN ENTITY OTHER THAN AN INDIVIDUAL.—For the purposes of subsection (b)(2) and paragraph (1) of this subsection—

(i) the term 'principal assets' does not include cash or cash equivalents; and

(ii) any equity interest in an affiliate is located in the district in which the holder of the equity interest has its principal place of business in the United States, as determined in accordance with subsection (b)(2).

(B) EQUITY INTERESTS OF INDIVIDUALS.—For the purposes of subsection (b)(1), if the holder of any equity interest in an affiliate is an individual, the equity interest is located in the district in which the domicile or residence in the United States of the holder of the equity interest is located, as determined in accordance with subsection (b)(1).

(d) BURDEN.—On any objection to, or request to change, venue under paragraph (2) or (3) of subsection (b) of a case under title 11, the entity that commences the case shall bear the burden of establishing by clear and convincing evidence that venue is proper under this section.

(e) OUT-OF-STATE ADMISSION FOR GOVERNMENT ATTORNEYS.—The Supreme Court shall prescribe rules, in accordance with section 2075, for cases or proceedings arising under title 11, or arising in or related to cases under title 11, to allow any attorney representing a governmental unit to be permitted to appear on behalf of the governmental unit and intervene without charge, and without meeting any requirement under any local court rule

relating to attorney appearances or the use of local counsel, before any bankruptcy court, district court, or bankruptcy appellate panel."; and

§ 1412. Change of venue

(a) IN GENERAL.—Notwithstanding that a case or proceeding under title 11, or arising in or related to a case under title 11, is filed in the correct division or district, a district court may transfer the case or proceeding to a district court for another district or division—

(1) in the interest of justice; or

(2) for the convenience of the parties.

(b) INCORRECTLY FILED CASES OR PROCEEDINGS.—If a case or proceeding under title 11, or arising in or related to a case under title 11, is filed in a division or district that is improper under section 1408(b), the district court shall—

(1) immediately dismiss the case or proceeding; or

(2) if it is in the interest of justice, immediately transfer the case or proceeding to any district court for any district or division in which the case or proceeding could have been brought.

(c) OBJECTIONS AND REQUESTS RELATING TO CHANGES IN VENUE.—Not later than 14 days after the filing of an objection to, or a request to change, venue of a case or proceeding under title 11, or arising in or related to a case under title 11, the court shall enter an order granting or denying the objection or request."

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Faculty

Kyler K. Burgi is an associate at Davis Graham & Stubbs LLP in Denver, where his practice focuses on bankruptcy and creditors' rights, complex commercial litigation and toxic tort litigation. He has a diverse bankruptcy and creditors' rights practice that spans multiple industries, including oil & gas, mining, real estate, retail, tech and recreation. Mr. Burgi currently serves as the co-chair of the Colorado Bar Association's Bankruptcy Subsection, as a member of the Prosper Colorado Leadership Council, and on the associate board of directors for Big Brothers Big Sisters of Colorado. He also has been named among the "Ones to Watch" in the area of Commercial Litigation by *The Best Lawyers in America*. Previously, Mr. Burgi clerked for Hon. Philip A. Brimmer of the U.S. District Court for the District of Colorado. He received his J.D. from the University of Denver Sturm College of Law, where he graduated first in his class. While in law school, he competed nationally as a member of the Sturm College of Law's ABA-NTC National Trial Team, served as an editor of the *Denver University Law Review*, and interned for the U.S. Attorney's Office. Prior to law school, Mr. Burgi worked as a television news reporter.

Deborah Chandler is a partner with Anderson & Karrenberg in Salt Lake City and currently serves as the firm's president. She represents debtors, creditors and trustees in all aspects of title 11 work, including subchapter V cases. Ms. Chandler is frequently called upon to represent defendants in various adversary proceedings, including avoidance actions and nondischargeability proceedings. In addition to successfully reorganizing companies in chapter 11, she has also represented debtors in private restructurings and state court dissolution proceedings. Ms. Chandler has represented receivers and defended actions brought by receivers. In addition to her bankruptcy practice, she maintains a diverse commercial and civil litigation practice. One of her specialties is probate litigation, including both guardianships and conservatorships. Ms. Chandler has been selected by her peers as a member of Utah's Legal Elite since 2017. She received two B.S. degrees *cum laude*, in finance and marketing, in 2004 from the University of Utah and her J.D. in 2008 from the University of Utah S.J. Quinney College of Law, where she received the CALI Award for highest grade in Intellectual Property and the College of Law Award for second-highest grade in Corporate Finance.

Michael F. Thomson is a shareholder with Greenberg Traurig, LLP, in Salt Lake City, where his practice focuses on navigating complex bankruptcy and receivership proceedings, workouts and related litigation. He also is a chapter 7 panel trustee and represents creditors, distressed companies, chapter 7 and 11 trustees, and court-appointed receivers in virtually all aspects of the workout, restructuring and liquidation process, including litigation and appeals. Mr. Thomson has been recognized in *The Best Lawyers in America* (Bankruptcy and Creditor Debtor Rights/Insolvency and Reorganization Law, and Litigation – Bankruptcy), *Super Lawyers* magazine, *Mountain States Super Lawyers* (Bankruptcy & Creditor/Debtor Rights) and *Utah Business* magazine's "Legal Elite" (Bankruptcy/Workout). He also is rated AV-Preeminent by Martindale-Hubbell. Mr. Thomson received his J.D. from the University of Utah College of Law, where he was an articles editor of the *Utah Law Review* and a William H. Leary Scholar.

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