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SPECIAL EDITION ON VENUE OF PREFERENCE ACTIONS

This edition of the Preference Quarterly Law Journal focuses on 28 U.S.C. § 1409(b) and the issue of venue of preference avoidance and recovery actions. We also look at an interesting bill affecting venue, presently believed to be in the

House Commercial and Administrative Law subcommittee. Past issues of the Preference Quarterly Law Journal are now available at our website: www.preferencequarterly.com

Conventional Wisdom and the “Preference Venue” Amendment

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At a seminar on BAPCPA I recently attended, there was a business breakout session where the preference amendments were to be discussed. The size and structure of the session were hospitable to questions from and interaction with the audience, so when the presenter got to the amendment to 28 U.S.C. § 1409 (which I’ll call the venue amendment), I asked my question.

“Has anyone raised the possibility that this amendment doesn’t even apply to preferences because they are actions ‘arising under’ the Code and the venue statute applies to actions ‘arising in or related to’ a bankruptcy case?”

Continued on page 2

28 U.S.C. § 1409(b): Applicable to Preference Actions?

The following is reprinted with permission from an article by Byron Starcher in the ABI Journal, Vol. XXV, No. 2, March 2006. The American Bankruptcy Institute is a multi-disciplinary, nonpartisan organization devoted to bankruptcy issues. ABI has more than 11,500 members, representing all facets of the insolvency field. For more information, visit ABI World at www.abiworld.org. Due to space limitations, the article reprinted herein has been revised and is slightly different from the article originally appearing in the ABI Journal.

Section 410 of the Bankruptcy Abuse Prevention and Creditor Protection Act (BAPCPA) amended 28 U.S.C. § 1409, which relates to venue of bankruptcy proceedings. As amended, § 1409(b) now states, in relevant part:

Continued on page 6

Conventional Wisdom, continued from page 1

A strange hush fell over the room. I sensed that the presenters and my fellow attendees thought that I might also believe the moon is made of cheese. The presenter to whom I'd directed the question looked at me and, with a tone that, to his credit, lent dignity to what he surely thought was a hopelessly misguided view of the new law, said, "All the commentators agree this is a preference amendment."

Is it really? Here is what the venue statute, 28 U.S.C. § 1409(b), says, with BAPCPA changes highlighted:

Except as provided in subsection (d) of this section, a trustee in a case under title 11 may commence a proceeding arising in or related to such case to recover a money judgment of or property worth less than \$1,000 or a consumer debt of less than ~~\$5,000~~ \$15,000, or a debt (excluding a consumer debt) against a noninsider of less than \$10,000, only in the district court for the district in which the defendant resides.

My question at that seminar focused on the "arising in or related to" language. I subsequently did some research and found two pre-BAPCPA cases that interpreted § 1409(b) as *not* applying to preference avoidance actions because they "arise under" the Code. *Ehrlich v. American Expr. Travel Related Servs. Co., Inc. (In re Guilmette)*, 202 B.R. 9 (Bankr. N.D.N.Y. 1996); *Van Huffel Tube Corp. v. A&G Indus. (In re Van Huffel Tube Corp.)*, 71 B.R. 155 (Bankr. N.D. Ohio 1987). See also *Official Employment-Related Issues Comm. of Enron Corp. v. Arnold (In re Enron Corp.)*, 317 B.R. 701, 706 (Bankr. N.D. Tex. 2004) ("Avoidance actions under 11 U.S.C. §§ 547 and 548 are not proceedings 'arising in or related to' the bankruptcy case"). According to these cases, the venue amendment has no application to preferences. Also notice that amended § 1409(b) makes no reference to preference avoidance or its

statutory home, § 547 of the Code.¹ If the "arising under" problem can be resolved so as to include preferences within the venue statute, would it not also apply to, for example, a fraudulent transfer or § 506(c) surcharge action?

The seminar presenter was certainly right about the consensus. From day one, the venue amendment has been described – not just in Congress, but also by intelligent and knowledgeable bankruptcy experts – as affecting nothing more and nothing less than actions to avoid preferential transfers. But having a consensus is not synonymous with being correct. Given the many technical problems with BAPCPA's drafting,² it is certainly not unthinkable that the drafters missed their mark on this intended change.

Just how did this consensus on the venue amendment come to be? I have a theory that relies in good measure on conventional wisdom.

The push to change the rule on who gets home field advantage in preference actions (along with other BAPCPA preference amendments) traces back to an American Bankruptcy Institute ("ABI") report on the results of a survey an ABI task force conducted on preferences. American Bankr. Inst. Task Force on Preferences, Charles Jordan Tabb, Reporter, PREFERENCE SURVEY REPORT, (ABI Bankruptcy Reform Study Project) (May 1997)

¹ By comparison, 28 U.S.C. § 1409(c) specifically refers to §§ 541 and 544(b) of the Code.

² See e.g., *In re Baldassarro*, 338 B.R. 178, n.3 (Bankr. D.N.H. 2006) ("The Court finds it very difficult to believe that lawyers retained by either the private interests that lobbied for the passage of BAPCPA or any staff attorneys for the various Congressional committees with oversight over BAPCPA could actually produce such a bad work product."); *CLLA Details BAPCPA's Technical Problems*, BANKRUPTCY COURT DECISIONS WEEKLY NEWS AND COMMENT, Sept. 27, 2005, at 8-9. (discussing CLLA position paper on BAPCPA's technical problems, including an interview with this author); Hon. Keith M. Lundin, *Ten Principles of BAPCPA: Not What Was Advertised*, 24 AMER. BANKR. INST. J. at 1 (Sept. 2005) ("The list of drafting errors and incomprehensible provisions grows every day as bankruptcy professionals digest BAPCPA.").

("Preference Survey Report"). As explained by the task force's reporter:

The Preference Survey Report, for which I served as Reporter, made four "Recommendations" for changes to the preference law and put forward nine "Other Ideas for Consideration." Several of these Recommendations and Other Ideas soon were adopted as Recommendations in the October 1997 Report of the National Bankruptcy Review Commission. Those Recommendations then were incorporated almost verbatim in each version of the many bankruptcy reform bills that were considered by Congress from 1997 to 2005, and were enacted as part of BAPCPA.

Charles Jordan Tabb, *The Brave New World of Bankruptcy Preferences*, 13 AM. BANKR. INST. L. REV. 425, 426 (2005).

The venue amendment, which was an Other Idea in the Preference Survey Report, was premised on a perception gleaned from the survey that an unacceptable number of preference avoidance actions are abusive or coercive.

Another aspect of the coercive litigation concern expressed by many respondents focused on the fact that the cost and inconvenience of having to defend a preference action in a distant forum may be significantly less than the amount sued for, creating settlement pressure, irrespective of the merits of the action ... Today current law (28 U.S.C. § 1409(b)) offers some protection to distant defendants by requiring suit to be brought in the district where the defendant resides if the amount sued for is less than \$1,000, or \$5,000 for a consumer debt. These amounts offer too little protection, though, to satisfy many of the respondents. For a non-consumer defendant, the \$1,000 rule of that section seems plainly insufficient.

Preference Survey Report at 25.³ The National Bankruptcy Review Commission ("NBRC") elevated this venue proposal from Other Idea to Recommendation. In its 1997 Report, the NBRC offered this:

3.2.2. Venue of Preference Actions under 28 U.S.C. § 1409

28 U.S.C. § 1409 should be amended to require that a preference recovery action against a noninsider seeking less than \$10,000 must be brought in the bankruptcy court in the district where the creditor has its principal place of business. The Recommendation applies to nonconsumer debts only.

NAT'L BANKR. REV. COMM'N, BANKRUPTCY: THE NEXT TWENTY YEARS 799 (1997) ("NBRC Report"). As the Preference Survey Report did in passing, the NBRC's justification for this recommendation focused squarely on § 1409(b).

Section 1409(b) provides that a proceeding to recover a money judgment or property worth less than \$1,000 must be commenced in the district court for the district in which the defendant resides. Section 1409(b) further provides that if the proceeding to recover a money judgment or property is on a consumer debt of less than \$5,000, the action must be commenced in the district court where the defendant resides. The purpose of this provision is to prevent unfairness to distant debtors of the estate, when the cost of defending would be greater than the cost of paying the debt owed.

The increased cost of defending a small preference action in a distant forum has encouraged reform of the preference venue rules. Consistent with the efforts to protect smaller trade creditors from certain preference litigation tactics, actions against

³ Note that the cited page is as the Preference Survey Report prints from the ABI's website, which is in HTML format.

noninsiders seeking recovery of an amount below \$10,000 should be commenced in the district where the creditor has its principal place of business. The purpose of this venue provision is to protect parties from “noneconomic” actions brought by trustees seeking to take advantage of the likelihood that it will cost the creditors more to litigate the action than the action itself seeks to recover.

Id. (Footnotes and quotations omitted).⁴

Together, the Preference Survey Report and the NBRC Report were the driving forces for what became the conventional wisdom on the venue amendment in two respects, the first being that § 1409(b) was the appropriate vehicle for the intended change and, second, that only preferences are affected. The credibility of the ABI and the NBRC likely served to strengthen the conventional wisdom; given that some of bankruptcy’s brightest minds were behind both the Preference Survey Report and the NBRC Report, it is neither unlikely nor unreasonable that others would assume the correctness of the proposals and explanations in each report.

Among those “others” is Congress. When the venue amendment first appeared in 1998, see H.R. 3150, 105th Congress § 208 (1998), its language was, as Professor Tabb has pointed out, a near verbatim copy of the NBRC Report’s recommendation. The first statement of Congressional intent, reflected in House Report 105-540 when the Judiciary Committee reported H.R. 3150 out of committee, was this:

⁴ The manner in which the NBRC discusses the consumer debt floor in § 1409(b) reflects a misunderstanding of the purpose of that floor. The NBRC Report favored leaving the consumer floor unamended so that “trustees in consumer cases will not have to litigate in the creditor’s forum unless the transfer is for less than \$5,000.” NBRC Report at 799. The point of the consumer floor in the venue statute, however, is to protect consumers, not creditors of consumer debtors. See 28 U.S.C. § 1409(b): How Do Recovery of Consumer Debts Relate to Recovery of Preferences, 2 PREFERENCE Q. L.J. 2-3 (April 2006).

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Section 208. Venue of Certain Proceedings

Section 208 amends the venue provisions for preferential transfer actions. A preferential transfer action in the amount of \$10,000 or less must be filed in the district where the defendant resides.

H.R. Rep. No. 105-540, at 94 (1998). Like the Preference Survey and NBRC Reports, the Judiciary Committee did not seem to notice the “arising in or related to” language problem, nor did the bill’s language limit the venue floor to preferences.⁵

But by this time, conventional wisdom had firmly set in. During hearings that were held by the Judiciary Committee’s Subcommittee on Commercial and Administrative Law in March 1998, virtually every witness who mentioned the venue amendment referred to it as a preference amendment. See, generally, Bankruptcy Reform Act of 1998; Responsible Borrower Protection Act; and Consumer Lenders and Borrowers Bankruptcy Accountability Act of 1998 (Parts I-IV): Hearing Before the Subcomm. on Commercial and Admin. Law of the House Comm. on the Judiciary, 105th Cong. (1998). Like the seminar presenter I referred to the outset of this piece, from the first days of the long journey that led to BAPCPA, all the commentators agreed that this was a preference amendment.⁶

⁵ The language of H.R. 3150’s venue amendment also created a conflicting thresholds problem by leaving unaltered the \$1,000 threshold already in § 1409(b) and adding to the subsection a \$10,000 threshold for nonconsumer debts against noninsiders. See, infra, 28 U.S.C. § 1409(b): Applicable to Preference Actions?, 2 PREFERENCE Q. L.J. at 9-10 (July 2006). The intent of the NBRC recommendation, however, was “to increase the \$1,000 amount under which a distant defendant on a nonconsumer debt is entitled to be sued in their home court.” Charles Jordan Tabb, *Panglossian Preference Paradigm?*, 5 Amer. Bankr. Inst. L. Rev. 407, 415 (1997).

⁶ See also, Byron C. Starcher, Second Thoughts on “Home Court Advantage” for Small-Dollar Preference Defendants, 25 AM. BANKR. INST. J. 10 (2006)

There is an interesting twist to this story, however. Ultimately, the only version of bankruptcy reform that matters, save for academic interest, is BAPCPA because that one is now the law of the land. Here is what the House Report accompanying BAPCPA says about the venue amendment:

Sec. 410. Venue of Certain Proceedings. Section 1409(b) of title 28 of the United States Code provides that a proceeding to recover a money judgment of, or property worth less than, certain specified amounts must be commenced in the district where the defendant resides. Section 410 amends section 1409(b) to provide that a proceeding to recover a debt (excluding a consumer debt) against a noninsider of the debtor that is less than \$10,000 must be commenced in the district where the defendant resides.

H.R. Rep. No. 109-31, at 88 (2005). The BAPCPA House Report purged any reference to “preferential transfer actions” and instead describes the venue amendment in a manner so benign that it does nothing but restate the amendment’s language. This is a remarkable change in the expression of Congressional intent because up through and including the 108th Congress, the various House Reports tied the venue amendment directly to preferences.⁷

(discussing commentators’ uniformity in describing the venue amendment as a preference amendment).

⁷ H.R. Rep. No. 108-040, at 193 (2003) (“Section 410 amends section 1409(b) of title 28 of the United States Code to provide that a preferential transfer action in the amount of \$10,000 or less pertaining to a nonconsumer debt against a noninsider defendant must be filed in the district where such defendant resides. This amount is presently fixed at \$1,000.”). This language was the same or substantially similar to all prior House Report statements on the venue amendment. *See, e.g.*, H.R. Rep. No. 105-540, at 94 (1998) (regarding H.R. 3150, 105th Congress (1998)); H.R. Rep. No. 106-123 Part I, at 95 (1999) (regarding H.R. 833, 106th Congress (1999)); H.R. Rep. No. 107-617, at 228 (2002) (regarding H.R. 333, 107th Congress (2002)).

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This Congressional change of heart could have an important practical effect, at least for those who accept the view that the plain language of § 1409(b) renders it inapplicable to preferences or any other action that arises under the Bankruptcy Code (or, conversely, that if § 1409(b) applies to preferences, then it applies to all actions arising under the Code). Until the 109th Congress, which gave us BAPCPA, there was a genuine conflict between the language and the intent of the drafters. It could not have been plainer that Congress meant to have low dollar preference actions filed in the defendant’s home district. Courts might have been able to work around the plain language to effectuate that clear intent. *United States v. Ron Pair Enters.*, 489 U.S. 235, 242 (1989) (“The plain meaning of legislation should be conclusive, except in the ‘rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters.’”) (quoting *Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 571 (1984)) (alteration in original).⁸

The BAPCPA House Report eliminates this possibility because Congressional intent is no longer clear. Prior statements of Congressional intent certainly cannot overcome the BAPCPA House Report, as courts are loathe to interpret a statute based on statements from other, failed bills. Indeed, the neutral description of the venue

⁸ Since the *Ron Pair* decision, the Supreme Court has become increasingly rigid in its adherence to the plain language rule, so even if BAPCPA’s House Report retained the stated intent to change venue for preferences, that intent could not be effectuated without a finding that the language of the amended venue statute is ambiguous. *See, e.g., Exxon Mobile Corp. v. Allapattah Servs.*, 125 S. Ct. 2611, 2626 (2005) (“[T]he authoritative statement is the statutory text, not the legislative history or any other extrinsic material. Extrinsic materials have a role in statutory interpretation only to the extent they shed a reliable light on the enacting Legislature’s understanding of otherwise ambiguous terms.”); *Ardestani v. Immigration & Naturalization Service*, 502 U.S. 129, 135-36 (1991) (citations omitted) (“The ‘strong presumption’ that the plain language of the statute expresses congressional intent is rebutted only in ‘rare and exceptional circumstances’ when a contrary legislative intent is clearly expressed.”).

amendment in the BAPCPA House Report could even be interpreted as a repudiation of those prior statements.

Equally interesting is the fact that *someone* on Capitol Hill apparently saw past the conventional wisdom and noticed that the so-called “preference venue amendment” wasn’t what everyone thought it was. Whether that someone also knew what the venue amendment was always intended to be is anybody’s guess. We’ll also never know if that someone thought, “How strange that the prior reports would describe this as a preference amendment,” or asked, “Mr. Sensenbrenner, did you notice that the language and legislative history of the venue amendment are out of whack?” (And we’re left to wonder why 21 members of Congress, five of whom serve on the Judiciary Committee, abandoned the BAPCPA approach to venue for preferences in H.R. 4296, which was introduced on November 10, 2005, and proposed to further amend

the venue statute to give preference defendants home field advantage in all cases by adding the following language to [section] 1409(b): “(2) ... a trustee in a case under title 11 may commence a proceeding under section 547 of such title only in the district court for the district in which the defendant resides.”) Meanwhile, it seems no one in the bankruptcy community noticed or found relevant the language change in the BAPCPA House Report because, according to the conventional wisdom, the venue amendment was unquestionably a preference amendment.

And so ends another chapter in the bankruptcy reform story. I leave speculation about the future of the venue amendment to the remaining pages of this Journal.

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1409(b) Applicable to Preference Actions? continued from page 1

... a trustee in a case under title 11 may commence a proceeding arising in or related to such case to recover a money judgment of or property worth less than \$1,000 or a consumer debt of less than \$15,000, or a debt (excluding a consumer debt) against a noninsider of less than \$10,000, only in the district court for the district in which the defendant resides.

Does 28 U.S.C. § 1409(b) Apply to Preference Actions?

Conventional wisdom seems to be that § 1409 now requires preference actions of less than \$10,000 to be brought in the defendant’s home court. The weight of nonjudicial opinion seems to be that § 1409(b) applied to or encompassed preference actions even before the BAPCPA. For example, the National Bankruptcy Review Commission Final Report recommended raising the floor in § 1409(b) to \$10,000 in nonconsumer cases to protect small trade creditors from abusive

preference litigation tactics. NAT’L BANKR. REV. COMM’N, BANKRUPTCY: THE NEXT TWENTY YEARS 799-800 (1997). Likewise, in 1999, the House of Representatives proposed an amendment to § 1409(b) that would require a proceeding “to recover a money judgment of or property worth less than \$1,000 or a consumer debt of less than \$5,000, or a nonconsumer debt against a noninsider of less than \$10,000” to be brought in the defendant’s home court. Bankruptcy Reform Act of 1999, H.R. 833, 106th Cong. § 212 (1999). The House Report accompanying the bill expressly stated that the change was to raise the floor on a “preferential transfer action” from \$1,000 to \$10,000. H.R. Rep. No. 106-123, at 139-40 (1999).

However, the argument that § 1409(b) does not apply to preference actions is simple enough and is based on the statute’s plain meaning. 28 U.S.C. §§ 1334(b) and 1409(a) recognize three kinds of bankruptcy proceedings: proceedings arising under Title 11, proceedings arising in a case under Title 11 and proceedings related to a case under Title 11. By its very terms, § 1409(b) applies only to “a proceeding arising in or related” to a case arising

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under Title 11 and does not apply to proceedings “arising under Title 11.”

A proceeding arising under Title 11 is one “invok[ing] a cause of action, or substantive right, created by a specific section of the Bankruptcy Code.” Continental Nat’l Bank of Miami v. Sanchez (In re Toledo), 170 F.3d 1340, 1349 (11th Cir. 1999). Proceedings arising in a case under Title 11 are described as “administrative matters unique to the management of a bankruptcy estate,” In re Toledo 170 F.3d at 1349, or proceedings that, while not expressly provided for under Title 11, have no existence outside of bankruptcy. Maitland v. Mitchell (In re Harris Pine Mills), 44 F.3d 1431, 1435 (9th Cir. 1995). Accordingly, it should be well-settled that § 547 preference avoidance actions are proceedings arising under Title 11. See, e.g., Wood v. Wood (In re Wood), 825 F.2d 90, 97 (5th Cir. 1987); Official Employment-Related Issues Comm. v. Arnold (In re Enron Corp.), 317 B.R. 701, 706 (Bankr. N.D. Tex. 2004). Recovery actions under § 550 should similarly be proceedings arising under Title 11. Gandy v. Gandy (In re Gandy), 229 F.3d 489, 497 (5th Cir. 2002). Because preference actions are proceedings arising under Title 11, so the argument goes, they are not subject to § 1409(b) under a plain meaning analysis.

At least four courts have directly addressed the question of whether § 1409(b) encompasses preference actions. Two held that § 1409(b) does not apply to preference actions based on the foregoing argument. Ehrlich v. American Expr. Travel Related Servs. Co., Inc. (In re Guilmette), 202 B.R. 9, 12-13 (Bankr. N.D.N.Y. 1996); Van Huffel Tube Corp. v. A&G Indus. (In re Van Huffel Tube Corp.), 71 B.R. 155, 156-57 (Bankr. N.D. Ohio 1987). The other two found that preference recoveries are governed by the venue provisions of § 1409(b). Muskin, Inc. v. Strippit, Inc. (In re Little Lake Indus., Inc., et al.), 158 B.R. 478 (B.A.P. 9th Cir. 1993); Armstrong v. Rainier Fin. Servs. Co. (In re Greiner), 45 B.R. 715, 716 (Bankr. D.N.D. 1985). Thus, courts have split on the issue.

Legislative History

If a statute is ambiguous, courts will turn to legislative history to try to determine the legislature’s true intent. The genesis of 28 U.S.C. §

1409 is found in the Bankruptcy Reform Act of 1978, which is formally the codification of H.R. 8200, 95th Cong. (1977). H.R. 8200 proposed a new 28 U.S.C. § 1473, which stated in part:

- (a) Except as provided in subsections (b) and (d) of this section, a proceeding arising under or related to a case under title 11 may be commenced in the bankruptcy court in which such case is pending.
- (b) A trustee in a case under title 11 may commence a proceeding arising under or related to such case to recover a money judgment of less than \$1,000 or a consumer debt of less than \$5,000 only in the bankruptcy court for the district in which a defendant resides.

The House Report accompanying H.R. 8200, H.R. Rep. No. 95-595 (1977) (hereinafter, House Report), explained that “[s]ubsection (b) permits venue of a proceeding commenced by a trustee to recover a money judgment of less than \$1,000 or a consumer debt of less than \$5,000 to be laid only in the district in which a defendant in the proceeding resides. This section prevents unfairness to distant debtors of the estate, when the cost of defending would be greater than the cost of paying the debt owed.” House Report at 446.

This explanation wholly fails to resolve the issue. Several things should be noted about the language in H.R. 8200. First, § 1473(b) refers to proceedings *arising under a case under Title 11* – not proceedings *arising under Title 11*. As will be discussed later, the term “proceeding arising under a case under Title 11” in the jurisdiction and venue sections of the bill would be replaced *en masse* by “proceeding arising in a case under Title 11” in a late amendment prior to passage. Second, both proposed § 1473(d) and proposed 28 U.S.C. § 1471, the latter dealing with jurisdiction of the bankruptcy courts, did refer to proceedings “arising under Title 11” as well as proceedings “arising under or related to cases under Title 11.” Thus, both § 1471 and § 1473 acknowledged the existence of proceedings arising under Title 11 as being separate and distinct from proceedings arising under a case under Title 11 and proceedings related to a case under Title 11.

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Third, subsection (a), which addressed general or default venue for proceedings, did not include proceedings arising under Title 11, which raises the question of where default venue for proceedings arising under Title 11 was supposed to lie.

However, the House Report stated that “[a]ny action by the trustee under an avoiding power would be a proceeding arising under title 11, because the trustee would be claiming based on a right given by one of the sections in subchapter III of chapter 5 of title 11.” House Report at 445. It further stated that, “with two exceptions, enumerated in subsections (b) and (d) [of § 1473], the court in which the bankruptcy case is pending is always a proper venue for proceedings arising under Title 11 or arising under or related to a case under title 11.” Id. at 446. Congress arguably understood that preference actions were proceedings arising under Title 11 and intended venue to be in the bankruptcy court in which the bankruptcy case is pending.

The Senate proposed a competing bill to H.R. 8200: S. 2266, 95th Cong. (1978). It proposed a new 28 U.S.C. § 1409(b) that was identical to the House’s proposed § 1473(b), except that venue was to be “in the judicial district in which a defendant resides.” As with § 1473(b) in H.R. 8200, the Senate’s proposed § 1409(b) addressed only venue of proceedings “arising under or related to cases under title 11” and failed to include proceedings “arising under Title 11.” While it added an example of the subsection’s application to a consumer debt case, the Senate Report accompanying S. 2266 provides no additional guidance on the question of whether subsection (b) was intended to apply to preference litigation. S. Rep. No. 95-989, at 155 (1978).

The differences between H. 8200 and S. 2266 were resolved by the managers of the two bills in September 1978 without a formal conference. The compromise reached was presented to the House on September 28 as a House amendment to the Senate amendment in the nature of a substitute. The venue section still proposed a new 28 U.S.C. § 1473(b), but the concept of a “proceeding arising under a case under title 11” was replaced with “proceeding

arising in a case under title 11.” 124 Cong. Rec. 32,385 (1978) (statement of Rep. Edwards). This same change was made throughout H.R. 8200’s venue and jurisdiction provisions. Thus, as amended and passed in the Bankruptcy Reform Act of 1978, § 1473(b) stated:

Except as provided in subsection (d) of this section, a trustee in a case under title 11 may commence a proceeding arising in or related to such case to recover a money judgment of or property worth less than \$1,000 or a consumer debt of less than \$5,000 only in the bankruptcy court for the district in which a defendant resides.

Unfortunately, because the amendments were made in informal conference, no record appears to exist that explains the substitution of proceedings “arising in a case under Title 11” for “arising under a case under Title 11.” Neither bill manager explained the changes, both reporting only that “[v]enue provisions pertaining to the new bankruptcy court have been described adequately in the House Report accompanying H.R. 8200.” Id. at 32,411 (Rep. Edwards); *id.* at 34,010 (Sen. DeConcini). Apparently, the substitution was merely a change in terminology having no real affect. Regardless, proceedings “arising under Title 11” remained absent.

Due to the Supreme Court’s Marathon decision,¹ Congress substantially revamped Title 28 in the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333 (1984). The bankruptcy proceeding venue provisions were relocated from 28 U.S.C. § 1473 to 28 U.S.C. § 1409, and substantial changes made. Proceedings arising under Title 11 were added to subsections (a) and (e). The addition in subsection (a) fixed the problem of missing default venue for proceedings arising under Title 11, and all three types of proceedings could now be brought in the district court in which the main case is pending. The only changes to subsection (b) corrected jurisdictional issues identified in Marathon so that,

¹ Northern Pipeline Constr. Co. v. Marathon Pipe Line Co., 458 U.S. 50, 102 S. Ct. 2858 (1982).

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despite being added in other subsections, proceedings arising under Title 11 remained conspicuously absent from subsection (b). No single report appears to explain the 1984 Act because it consisted of a Senate amendment in the form of a substitute to H.R. 5174, and the amendment itself was a compromise blend of provisions from at least three different bills or amendments. However, the legislative material surrounding the 1984 Act indicates Congress did not intend to change the substantive effect of the venue provisions in 1978 Act.²

Section 1409 was amended again by BAPCPA in 2005. While subsection (b)'s floor amounts have changed, as discussed in greater detail in the next section, it still lacks any reference to proceedings arising under Title 11. The section of the House Report accompanying S.256 (enacted as BAPCPA) provides no explanation as to why proceedings arising under Title 11 are not included or whether subsection (b) is intended to include preferences. H.R. Rep. No. 109-31, at 88 (2005).

Congress has had three opportunities to include proceedings arising under Title 11 in § 1409(b) (and its predecessor, § 1473(b)), but has failed to do so. Given the other changes made to the venue provisions over the years, a court today may be hard-pressed to find that Congress has not intentionally excluded proceedings arising under Title 11, including preferences, from the operation of subsection (b).

² See, e.g., 130 Cong. Rec. 13,062 (1984) (Statement of Sen. Thurmond) (venue “provisions are essentially the same as those in the Bankruptcy Reform Act of 1978, with necessary modifications to accommodate the continued jurisdiction of the district court over such matters”); S. Rep. No. 98-55, at 19 (1983) (accompanying S. 1013) (venue provisions “virtually identical to corresponding sections of the 1978 Act, with the exception of providing for venue in the district courts rather than in the bankruptcy courts”); H. Rep. No. 98-9, at 27 (1984) (accompanying H.R. 3, 98th Cong. (1984), which proposed adding proceedings arising under Title 11 to § 1473(a): venue provisions are “same as present law”).

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If 28 U.S.C. § 1409(b) Applies to Preference Actions, What Floor Applies?

If 28 U.S.C. § 1409(b) applies to preferences, what is the floor below which a trustee must sue in the defendant's home court? Subsection (b), as amended by BAPCPA, now applies to proceedings “arising in or related to such case to recover a money judgment of or property worth less than \$1,000 or a consumer debt of less than \$15,000, or a debt (excluding a consumer debt) against a noninsider of less than \$10,000.”

Leaving aside consumer and insider debts, which floor applies to preferences: \$1,000 or \$10,000? One answer could be that, if § 1409(b) applied to preferences before BAPCPA, a preference action must seek to recover either property or a money judgment because these were the recoveries available pre-BAPCPA. Since the floor for each of these recoveries remains at \$1,000 after BAPCPA, a party can argue that the \$1,000 floor still applies to preferences, and the \$10,000 floor applies to something else.

Analyzing whether a preference action seeks to recover property, a money judgment or a debt provides no better answers. If the trustee seeks to recover tangible property (as opposed to the value of such property) under 11 U.S.C. § 550(a), the trustee is, presumably, recovering property as defined in 28 § 1409(b), which is subject to a \$1,000 floor. Furthermore, through operation of 11 U.S.C. §§ 541(a)(4) and 551, avoided transfers are property of the estate, and a recovery action is arguably seeking to recover this property.

And how does a court determine whether a preference recovery involves recovery of a debt rather than recovery of a money judgment, or vice-versa? The House Report accompanying S.256 (enacted as BAPCPA) provides no guidance as it merely parrots the language of § 1409(b) as amended. Recovering a debt might conceivably encompass more remedies than recovering a money judgment, i.e., recovering a money judgment is a subset of the remedies available to recover a debt. Thus, equitable actions and actions to recover property might be actions to recover a debt and not

to recover a money judgment. Of course, many of these actions seek to recover property, which conflicts with the \$1,000 property-recovery floor provision in § 1409(b). Recovering on a money judgment might also suggest a liquidated claim (which should apply to preferences), while recovering a debt might suggest an unliquidated claim. Regardless, the terms recovering a money judgment and recovering a debt have been used interchangeably, and recovery of a preference could be either one. See, e.g., Mann-Paller Foundation, Inc., v. Econometric Research, Inc., 644 F. Supp. 92, 94, 95 (D.D.C. 1986).

The answer may be that a preference recovery is both, in which case the \$10,000 floor should apply. Applying the \$1,000 floor and permitting the trustee to bring a \$6,000 preference action in the trustee's home court directly contradicts the requirement, with respect to recovery of a debt, that the action be brought in the defendant's home court. However, nothing in subsection (b) requires a proceeding to recover a money judgment for \$1,000 or more to be brought in the trustee's home court, so applying a \$10,000 floor complies with all of the language in subsection (b).

If 28 U.S.C. § 1409(b) Applies to Preference Actions, Does It Even Matter?

So far, this article has addressed the extent to which § 1409(b) applies to preference actions in general, and we have conveniently ignored the distinction between avoiding preferences under § 547(b) and recovering avoided preferences under § 550(a). Practitioners typically combine the two actions in one complaint. However, § 550(a) clearly contemplates a two-step approach of avoidance and, separately, recovery.

While a court can plausibly apply § 1409(b) to § 550 recovery actions (because § 1409(b) refers to recovery of property, money judgments, and debts), we do not believe a court can plausibly extend § 1409(b) to avoidance actions under § 547(b). This raises the interesting possibility that a trustee might bring just an avoidance action in the bankruptcy court in which the main case is pending without regard to the § 1409(b) dollar floors. Once the trustee has avoided the transfers in her own court, she can recover a money judgment in the defendant's home court (pursuant to § 1409(b)) on summary judgment or possibly even judgment on the pleadings. The hard part for the trustee, in a litigation sense, is winning the avoidance action, which she can still do in her own home court. To have any hope of averting an eventual money judgment, a preference defendant must still litigate the avoidance action in the trustee's court. In the vast majority of cases, the trustee need not even worry about venue of the subsequent recovery action because the parties will settle the avoidance action on terms requiring payment by the defendant. The trustee would need to be careful that *res judicata* would not apply for failing to bring the recovery action with the avoidance action, but the recovery action might not be cognizable until after the preferential transfer is avoided. See Fed. R. Civ. P. 18(b).

Conclusion

The only real conclusions that can be reached are that (i) 28 U.S.C. § 1409(b) on its face appears to exclude from its operation proceedings arising under Title 11, which would include preference actions among other avoidance actions, and (ii) the floor limitations are ambiguous. It will be interesting to see how the courts sort this one out. Regardless, we believe a plaintiff should be able to avoid § 1409(b) altogether in most cases by bifurcating the preference action into an avoidance action separate and distinct from the recovery action. Whether bifurcation makes economic sense will depend on the situation.

House Declares War: On Preferences, That Is

A bill has been introduced in the House of Representative that would radically change preference litigation. The bill provides for a new § 547(j), which states, in part:

For the purposes of [§ 547], the [defendant] against whom recovery or avoidance is sought is presumed to have carried the burden of proving the nonavoidability of a transfer under subsection (c) unless the trustee proves that such creditor or such party is an insider or that the debtor has a special relationship with such creditor ...

The special relationship exceptions include the circumstance in which the future debtor provides “explicit notice” before the transfer that a bankruptcy is contemplated or imminent. Another exception exists when the transfer “may have been made” with respect to judicial process used by the creditor to collect on a debt – in other words, a transfer well outside ordinary course because judicial process was used in an attempt to collect.

The bill also includes the following change to 28 U.S.C. § 1409(b) with respect to venue:

Except as provided in subsection (d) of this section, a trustee in a case under title 11 may commence a proceeding under [§ 547] only in the district court for the district in which the defendant resides.

Thoughts on the Innocent Supplier Fairness Act

First of all, you gotta love the bill’s title. Who could vote against an act providing fairness to innocent suppliers? Congress certainly knows how to name a bill to get the widest possible support.

The obvious result of the bill is to make it more difficult for the trustee to prevail on a preference action. The policies underlying the Bankruptcy Code are policies envisioned by Congress, and Congress may certainly re-prioritize policies and

purposes of the Code. The bill demotes the policy of equality of distribution and promotes the idea that prepetition transfers should be left alone unless tainted. When preference litigation results only in redistributing money amongst nonpriority creditors – less attorneys’ fees – this may not be entirely unwarranted. A trustee may still bring the same preference actions as before, but will be more selective in the actions he or she chooses to bring.

The language that the defendant creditor “is presumed to have carried the burden of proving the nonavoidability of a transfer” is clumsy. Since very similar language in § 547(f) has been interpreted as creating a rebuttable presumption of insolvency, we assume the presumption of nonavoidability would also be rebuttable. Forward-looking language such as “shall have the burden of proving” or “shall have the burden of proof” would be preferable. See, e.g., 16 U.S.C. § 4910(b); 19 U.S.C. § 1592(e); 26 U.S.C. § 6015(c)(2).

A larger concern is that the language apparently means a creditor is presumed to have the § 547(c) defenses, and to prevail, a trustee would have to prove that none of the nine defenses apply. In all likelihood, the nonapplicability of most of the defenses will be self-evident and can be dealt with through requests for admission. In most cases, the trustee will have to prove only that ordinary course and new value do not apply. If a case can be boiled down to these two issues, shifting the burden to the trustee is hardly unfair, especially since the § 547(c) “defenses” are arguably not defenses at all, but limitations on avoidability that maybe the trustee should have the burden of proving.

The venue change is troubling. While we strongly oppose coercive preferences, shifting the forum of all preferences to the defendant’s home court goes too far. It precludes the use of the knowledge acquired by the bankruptcy judge that oversaw the case. It allows many recipients of voidable transfers off “scot-free” due to increased costs of prosecution. And it runs counter to the principle that matters relating to the estate should be resolved in one forum, if possible. More thorough treatment of the issue may follow in future PQLJ issues, if this bill goes further. Stay tuned.

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