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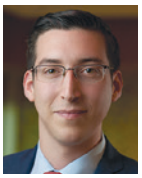
The 'Home Field' Venue Defense to Small Preference Claims: Going, Going, Gone?

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A trade creditor is certainly frustrated when a customer with a large unpaid balance files Chapter 11, leaving the collectability of the claim in question. But even more frustrating is the risk that the creditor also may be compelled to disgorge "preference" payments that the creditor received within the 90 days of the debtor's bankruptcy filing in addition to potentially recovering only pennies on the dollar on its claim.

Adding even further insult to injury, debtors frequently pursue preference claims *en masse* against their creditors and use the recoveries from those preference claims to fund their Chapter 11 cases, such as by paying higher priority administrative expense claims. This is the harsh reality seen in the recent Chapter 11 cases of *Sears/Kmart and Southern Foods (Dean Foods).*

One potential shield against this practice has been the "home field" defense to small preference claims. Specifically, the U.S. Code provides that small claims must be brought in the defendant's home district, rather than in the district in which the bankruptcy case is pending if such claims fall below a certain dollar amount. Congress increased that dollar amount from $13,650 to $25,000 when it passed the Small Business Reorganization Act of 2019 (SBRA), which became effective Feb. 19, 2020. However, while Congress may have intended this increased minimum venue threshold to provide heightened protection for creditors defending preference complaints, the reality is that the SBRA may have diminished preference defendants' ability to dismiss complaints based on the minimum venue threshold.

Prior to the enactment of the SBRA, the courts had been divided over whether the minimum venue threshold applies to preference actions because the statute does not explicitly state that it does. When Congress amended the venue statute to increase the minimum venue threshold, it had failed to further amend the statute to explicitly make it applicable to preference actions. This inaction has sparked a rash of court decisions rejecting the applicability of the minimum venue threshold to such actions.

Background

Section 1409 of Title 28 of the U.S. Code (Section 1409) governs the proper venue for bankruptcy matters. According to Section 1409(a), three types of matters may generally be commenced in the district where a bankruptcy case is pending: (1) those *arising under* the Bankruptcy Code, (2) those *arising in* the applicable bankruptcy case, and (3) those *related to* the applicable bankruptcy case.

Matters *arising under* the Bankruptcy Code are precisely that—proceedings that are expressly created or determined by the Bankruptcy Code. The courts and practitioners largely agree that preference and

other avoidance claims, such as fraudulent transfers, arise *under* the Bankruptcy Code because they are expressly created under Bankruptcy Code sections 547 and 548.

Matters *arising in* a proceeding under the Bankruptcy Code only occur in bankruptcy cases but are not expressly created by the Bankruptcy Code. They include objections to claims and to a debtor's discharge, actions seeking turnover of property of a debtor's bankruptcy estate, and proceedings to determine the validity, priority and extent of liens. Finally, matters *related to* a bankruptcy case are matters that could be pursued entirely outside of bankruptcy but "the outcome [of such claims] could conceivably have an effect on the estate being administered in bankruptcy."

Section 1409(b) limits Section 1409(a)'s general venue provision by establishing a floor for lawsuits that can be brought in the district in which a bankruptcy case is pending, i.e., a minimum venue threshold. If a claim is for less than the minimum venue threshold, a trustee can commence a lawsuit to recover that claim only in the defendant's "home" district (where the defendant resides), and not in the district where the bankruptcy case is pending (unless, of course, the district where the bankruptcy is pending is the defendant's home district).

The legislative intent behind Section 1409(b)'s minimum venue threshold is to protect potential defendants from having to incur litigation defense costs that might very well exceed (or come close to) the amount of the claim asserted by the plaintiff. This protection would be particularly helpful to potential preference defendants. Without this protection, bankruptcy trustees and debtors can pursue preference claims and file complaints *en masse* against creditors all within the single district where the bankruptcy case is pending, regardless of the small amount sought or where the defendants reside.

This practice tilts the pendulum too much in favor of the plaintiff (i.e., the trustee or debtor) and against creditors defending small preference claims. While there is little additional cost for a plaintiff to include small preference claims among the slew of complaints filed in the main bankruptcy case, each individual out-of-state defendant must incur the cost of defending against the complaint filed against it—even if the cost of defending exceeds the amount of the preference claim. This puts pressure on the defendant to either fully pay the amount demanded or settle on favorable terms to the trustee in order to avoid incurring significant legal fees to defend the action.

That said, preference defendants have been bedeviled by the drafting of Section 1409(b), and the devil is in the details—not as to what the statute says, but as to what it *does not* say. Specifically, Section 1409(b) provides that if the amount sought is under the minimum venue threshold, then "a trustee [or debtor-in-possession] may commence a proceeding *arising in or related to* such [bankruptcy] case ... only in the . . . district in which the defendant resides." The lack of an explicit reference in Section 1409(b) to matters *arising under* the Bankruptcy Code (which includes avoidance actions, such as preference claims) has caused disputes as to whether preference actions are subject to the venue statute's minimum threshold.

Pre-SBRA: The Divide Among the Courts

Prior to the enactment of the SBRA, the courts were divided over the applicability of the minimum venue threshold to preference actions. Several courts held that Section 1409(b) and its minimum venue threshold do not apply to preference actions and preference actions below the threshold can be brought in the district where the bankruptcy case is pending regardless of where the defendant resides. These courts include courts in the Northern District of Ohio (*Matter of Van Huffel Tube Corp.* in 1987), the Northern District of New York (*In re Guilmettte* in 1996), the Middle District of Pennsylvania (*In re Polinski* in 1998), and the Western District of Michigan (*In re Rosenberger* in 2008).

Courts that rejected attempts to apply the minimum venue threshold to preference actions relied on the well-settled principle that the plain language of a statute must be given its ordinary meaning where the language is unambiguous. Section 1409(b) unambiguously omits matters *arising under* the Bankruptcy Code. Also, these courts concluded that the omission of matters *arising under* the Bankruptcy Code from Section 1409(b) cannot be written off as a mere oversight because Congress had explicitly included matters *arising under* the Bankruptcy Code in the general venue provision of Section 1409(a). As the U.S. Supreme Court explained in *Lamie v. United States Trustee*:

> [When] Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion . . . If Congress enacted into law something different from what it intended, then it should amend the statute to conform to its intent. It is beyond our province to rescue Congress from its drafting errors and to provide for what we might think . . . is the preferred result.

However, other courts have held that Section 1409(b)'s minimum venue threshold applies to preference actions for a number of reasons. For example, in *Little Lake Indus. Inc.*, the Ninth Circuit's Bankruptcy Appellate Panel ruled that Section 1409(b)'s failure to explicitly reference matters arising under the Bankruptcy Code is irrelevant because all proceedings *arising under* the Bankruptcy Code also arise in bankruptcy cases. Therefore, Section 1409(b)'s inclusion of arising in proceedings also implicitly includes *arising under* proceedings, such as preference actions.

Other courts applying Section 1409(b)'s minimum venue minimum threshold to preference actions have found that doing so is consistent with Section 1409(b)'s clear legislative history. For example, in *In re Dynamerica Mfg. LLC*, the Delaware bankruptcy court, in 2010, had ruled that the minimum venue threshold applies to preference actions. The court heavily relied on the legislative intent behind Section 1409(b)(b) of protecting defendants from having to defend small claims in a distant forum. The court also concluded that Congress's omission of "arising under" from Section 1409(b) must have been unintentional.

Other courts applying Section 1409(b)'s minimum venue threshold to preference actions have relied on an apparent inconsistency in another subsection of the venue statute—Section 1409(c). Section 1409(c) provides that a trustee "may commence a proceeding *arising in or related to* such case as statutory successor to the debtor or creditors under section 541 or 544(b) of [the Bankruptcy Code]" in a venue that is not where the bankruptcy case is pending. Like Section 1409(b), Section 1409(c) only uses the phrases "arising in" and "related to," even though Section 1409(c) necessarily covers matters that arise under the Bankruptcy Code (e.g., matters under Section 541 or 544(b) of the Bankruptcy Code). Because Congress must have implicitly intended to include certain *arising under* matters in Section 1409(c), it stands to reason that Congress had intended to implicitly include *arising under* matters in subsection (b), notwithstanding Section 1409(b)'s omission of that phrase.

The conflicting interpretations of Section 1409(b) prompted the Commission to Study the Reform of Chapter 11 that the American Bankruptcy Institute (ABI) had established to propose amending Section 1409(b) to clarify that the minimum venue threshold applies to preference actions, among its recommendations. The ABI Commission also recommended increasing the minimum venue threshold to $50,000.

Congress only partially answered the ABI Commission's call to amend Section 1409(b). Though as part of the SBRA, Congress had amended Section 1409(b) to increase the minimum venue threshold amount to $25,000; Congress did not further amend Section 1409(b) to subject causes of action *arising under* the Bankruptcy Code to the minimum venue threshold. The fact that Congress did not address this hot-button issue in the process of amending Section 1409(b), despite the well-publicized division among the courts, has had a significant impact on how courts have interpreted Congress's intent regarding the applicability of Section 1409(b)'s small venue threshold to preference actions since the enactment of the SBRA.

Post-SBRA: Small Venue Threshold and Preference Actions

Just as actions speak louder than words, Congress's inaction has spoken far louder than the omission of "arising under" proceedings in Section 1409(b). Congress's failure to amend Section 1409(b) to expressly include proceedings *arising under* the Bankruptcy Code appears to have been the tipping point for a rash of post-SBRA court decisions that the minimum venue threshold does not apply to preference actions. As the U.S. Bankruptcy Court for the Middle District of North Carolina noted in its decision issued in 2020 in the case of *In re Cirino Construction Co., Inc.,* "Congress had the perfect opportunity to fix the mistake and resolve the judicial schism with the [SBRA] . . . [t]he fact that Congress did not amend the plain language of [Section 1409(b)] to include 'arising under' leads to the conclusion that the omission of 'arising under' was intentional."

The *Cirino* Court is not alone. In fact, since the enactment of the SBRA, courts have consistently held that Section 1409(b)'s minimum venue threshold *does not* apply to preference actions. This includes courts in the Eastern District of New York (*In re Novak* in July 2020 and *In re Petland Discounts, Inc.* in January 2021), the Central District of Illinois (*In re Munson* in April 2021), and, most recently, the District of Delaware (*Insys Theraputics, Inc.* in June 2021).

In *Insys Theraputics*, the Delaware bankruptcy court denied a defendant's motion to dismiss a preference claim that fell below Section 1409(b)'s minimum venue threshold in a tellingly concise opinion. The bankruptcy court concluded that Section 1409(b)(9)'s minimum venue threshold does not apply to preference actions because Section 1409(b) omits proceedings *arising under* the Bankruptcy Code, which include preference actions. The bankruptcy court did not distinguish the reasoning of prior decisions, including the Delaware bankruptcy court's prior decision in *Dynamerica*, that Section 1409(b) applies to preference actions. Rather, the *Insys Theraputics* court simply stated that "only when statutory text is ambiguous do we consider 'other indicia of congressional intent such as the legislative history,'" and "[t]here is simply no reason to conclude, given the clear language of [Section] 1409, that Congress accidentally failed to include arising under in the exceptions to general venue under [Section] 1409(b)."

Conclusion

While not every court rejecting the applicability of the small venue threshold in Section 1409(b) to preference actions has explicitly cited Congress's failure in the SBRA to amend 1409(b) to include proceedings arising under the Bankruptcy Code as the basis for its holding, the trend is undeniable. Courts are increasingly likely to rely solely on the plain language of Section 1409(b) and hold that the minimum threshold for venue does not apply to preference (and other avoidance) actions. This trend is particularly real now that a bankruptcy court in one of the country's most active districts for large Chapter 11 filings, the District of Delaware, recently issued a decision that is contrary to its prior holding in *Dynamerica* that preference actions are subject to Section 1409(b)'s minimum venue threshold.

Only time will tell if any courts will buck this trend—but do not hold your breath for many headline-grabbing appeals. By definition, the claims at issue are too small for it to be economically feasible to pursue significant litigation and appeals on the applicability of the minimum venue threshold to preference actions. As a result, there likely will be little or no binding precedent from appellate courts on this issue and bankruptcy and district courts will have discretion when ruling on this issue. That means trade creditors and other potential preference defendants should continue to raise Section 1409(b) as a defense to any preference claims that fall below the minimum venue threshold as part of their preference defense toolkit.