THE BANKRUPTCY VENUE CRISIS

1) BACKGROUND

Forum shopping in bankruptcy has reached epidemic levels. A recent study shows that 70 percent of public companies have filed their chapter 11 cases in venues outside of the district where their principal place of business or principal assets are located. Eighty percent of those companies filed in the District of Delaware or the Southern District of New York. In total, between 2004 and 2012, research indicates that 559 Chapter 11 bankruptcy cases were filed in the District of Delaware and another 104 Chapter 11 bankruptcy cases were filed in the Southern District of New York involving business debtors headquartered in a different state. These cases involved approximately $2 trillion in debt, 4.5 million creditors and more than 2 million employees, all administered by courts having no meaningful connection with the subject debtors. This trend is not limited to large public companies. Almost half of the Delaware cases involved smaller businesses with less than $15 million in assets at the time of filing. The full report of the research and findings, along with other articles on venue reform can be found at:

http://www.clla.org/resources/venue_reform.cfm

2) CONSEQUENCES

The growing frequency of forum shopping by debtors and other interests are having a serious and debilitating impact on the practice of bankruptcy law. Indeed, Judge Rhodes recently published an opinion piece in the Wall Street Journal calling the current bankruptcy venue law “the single most significant source of injustice in chapter 11 bankruptcy cases.”

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1 Judge Rhodes' article is attached as Exhibit A.
a) Venue Manipulation Threatens the Legitimacy of the Bankruptcy System

Seven out of every ten public companies that file chapter 11 file outside of their home states. A disproportionate number of large and middle market companies file in Delaware or the SDNY in search of desired outcomes at the expense of trade creditors, employees and other constituents. By allowing debtors to choose where to reorganize, the system appears to be manipulable in favor or corporate and large-mooneyed interests. In the Patriot Coal case it was noted by the press that "Lenders and lawyers who get the big cases like taking their troubles to courts in New York and Delaware, which are convenient to their homes and offices and attuned to their concerns". Rampant forum shopping directly threatens the integrity of the bankruptcy system by eroding public confidence and calling into question the fairness of a system that can be so easily manipulated.

b) Venue Shopping Disenfranchises Creditors, Employees and Others

In 1997 the Bankruptcy Review Commission issued findings for improving the practice of bankruptcy for the coming 20 years and noted that by allowing debtors the ability to file Chapter 11 cases in remote jurisdictions, local constituents were in effect being deprived of their due process. By concentrating cases in two districts smaller creditors, employees, retirees and other local parties with an interest in the bankruptcy case had no effective way to actively participate in the process. The situation has continued to deteriorate over time. The result is a growing level of indifference and distrust among creditor, employee and retiree constituents unable to participate actively in a process that directly affects their interests. The concentration of cases in two venues exacerbates the impact of forum shopping on these smaller constituents by tilting the playing field toward financially sophisticated parties who regularly appear in those courts.

c) Centralization of Cases Impairs the Balanced Development of Bankruptcy Law

The concentration of business filings in Delaware and SDNY has had the unintended consequences of creating two "super courts" with a duopoly on Chapter 11 jurisprudence. Other bankruptcy courts lose the ability to provide their input into the development of a rich body of experience and case law interpreting the Bankruptcy Code, with related federal appellate courts developing a consensus of controlling precedent. In addition, there is no assurance that the decisions by the duopoly are appropriate for all 94 federal districts or are even the proper interpretations. Absent the benefit of points of view from other courts, these decisions may be left unchallenged and are in fact strengthened by repeated application over time by cases filed in the same district before
the same judges. This is not what the Framers intended when they contemplated the development of a uniform bankruptcy law.

3) **SUGGESTED ACTION**

   a) **First**, the CLLA encourages that the United States Trustee's Office undertake a more active role in the forum selection of chapter 11 cases, especially those filed in Delaware and in the SDNY by out of state companies. When appropriate, the UST should initiate and/or support motions to transfer venue pursuant to 28 U.S.C. Section 1412.

   b) **Second**, the CLLA requests that the UST assist in the development and enactment of appropriate bankruptcy venue reform legislation.²

   c) **Third**, the CLLA recommends that the UST help to insure that there is adequate statistical recording keeping and analysis as it pertains to venue and transfer issues, in order to better monitor the status and impact of the venue issue on the practice of bankruptcy law and the administration of the bankruptcy system.

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² Proposed changes to the bankruptcy venue statute are attached as Exhibit B.
EXHIBIT A
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The Baffling Rejection of Venue Reform by the ABI Chapter 11 Reform Commission

By Steven Rhodes

In its final report and recommendations, adopted on Dec. 1, 2014, the ABI Commission to Study the Reform of Chapter 11 refused to recommend any changes to the venue rules for chapter 11 bankruptcy cases.

Actually, the report states that the commissioners "were unable to reach a consensus regarding whether reform of the venue statute was necessary or what potential reform might best serve the diverse interests in chapter 11 cases."

This is, of course, a polite way of saying that a majority of the commission voted to reject all venue reform proposals and to maintain the status quo.

Unfortunately, the report, adopted in December, provides no justification for this determination. Instead, the report states, "the Commission concluded that it could contribute most meaningfully to the ongoing dialogue concerning chapter 11 venue by providing this summary of its research and deliberations."
What followed in the report was that summary, which graciously included an acknowledgment of the position of the undersigned on this issue. The report hints at the reason for this absence of any stated justification: "The Commissioners found these issues among some of the most difficult and divisive issues considered during the Commission project." But nothing in the report discloses the actual reasons why a majority of the commission determined not to recommend venue reform.

The commission's rejection of chapter 11 venue reform was a serious mistake, as was its refusal to provide any basis for it. The current bankruptcy venue law is the single most significant source of injustice in chapter 11 bankruptcy cases.

Under current law, a chapter 11 debtor may file in the federal judicial district where its only connection is its incorporation, or in any district where a subsidiary has filed a bankruptcy case. Indeed, it is not too far-fetched to conclude that under the present venue law, many large corporations can find a way to file for chapter 11 bankruptcy relief in any of our 91 judicial districts. Most choose either the District of Delaware or the Southern District of New York.

For at least the four reasons developed below, the law should be changed to require that a chapter 11 case must be filed either in the district of the debtor's principal place of business or principal assets, or in the district where an affiliate has filed for bankruptcy relief when the affiliate owns more than 50% of the debtor's voting shares.

The Accepted Purposes of Venue Restrictions Require This Reform
The analogy of a defendant in a civil action to a creditor in a bankruptcy proceeding is imprecise but it rings true enough in the venue context. In civil litigation, the primary purpose of statutory venue restrictions is to protect the defendant against the plaintiff's unfair or inconvenient venue choice. The Supreme Court, in Leroy v. Great W. United Corp. (1979), observed, "In most instances, the purpose of statutorily specified venue is to protect the defendant against the risk that a plaintiff will select an unfair or inconvenient place of trial." Many other cases echo this view.

Likewise, the purpose of restricting venue in bankruptcy ought to be to protect creditors against the debtor's "unfair or inconvenient" venue choice. Why else have any venue laws? In large cases, the current law, however, does not accomplish that purpose, or really any purpose.

On the other hand, requiring a debtor to file where its principal place of business is located, although perhaps imperfect, is more likely to fulfill this purpose. The Supreme Court, in Hertz Corp. v. Friend (2010), defined a corporation's principal place of business as "the place where a corporation's officers direct, control, and coordinate the corporation's activities...the corporation's 'nerve center'...the place where the corporation maintains its headquarters." Significantly, the Supreme Court also observed, "The public often (though not always) considers it the corporation's main place of business."

Creditors and the public can reasonably expect that a debtor should be required to file its reorganization proceeding in the district of its principal place of business. Only with that restriction can the historical purpose of venue restrictions be fulfilled.

Concerns for Judicial Legitimacy Require This Reform
Legitimacy is essential to the proper functioning of the judiciary. In Planned Parenthood v Casey (1992), the Supreme Court cautioned, "As Americans of each succeeding generation are rightly told, the [Supreme] Court cannot buy support for its decisions by spending money and, except to a minor degree, it cannot independently coerce obedience to its decrees. The Court's power lies, rather, in its legitimacy."
There are many elements necessary to establish and maintain judicial legitimacy. As Lon L. Fuller argues, chief among those elements is the opportunity for parties to participate in the judicial process: "[T]he distinguishing characteristic of adjudication lies in the fact that it confers on the affected party a peculiar form of participation in the decision, that of presenting proofs and reasoned arguments for a decision in his favor. Whatever heightens the significance of this participation lifts adjudication toward its optimum expression. Whatever destroys the meaning of that participation destroys the integrity of adjudication itself."

Similarly, Richard B. Katskee has written, "Courts' legitimacy depends, in other words, not just on individual losing parties' walking away with the conviction that a courtroom was the proper venue to resolve grievances (however upset the parties might have been about the final verdict), but on the public's having faith that the legal process will afford a fair hearing and generally fair treatment to those who invoke it—and that the courts will give careful, respectful consideration even to nonparties' interests when they are implicated in lawsuits."

Venue shopping in chapter 11 cases undermines judicial legitimacy when it prevents or even impairs the meaningful participation of any of the parties. It also undermines the integrity of the adjudicative process itself.

Because the fulfillment of the judiciary's mission depends so fundamentally on its legitimacy in the eyes of the public, chapter 11 venue should be carefully restricted to maximize the participation of the parties. Although no single venue in a large chapter 11 case may perfectly facilitate this goal, venue in the district of the debtor's principal place of business does offer the best opportunity.

The Injustice of Law-Shopping Demands This Reform
Our legal system commonly and naturally experiences conflicts in judicial decisions on important issues of bankruptcy law. To facilitate venue shopping, law firms representing debtors often maintain elaborate charts detailing the conflicting rulings on the issues that concern their clients. Under our current venue law, this practice is in the best interest of any debtor client. This observation is therefore not a criticism of this practice under the current venue laws.

But venue laws ought not allow one party in litigation to choose the law that will apply to its case. This is highly prejudicial to the other parties in the case. Law shopping is unjust.

There is no sound reason why, for example, a debtor that is based in Fairbanks, Alaska, and that has a collective bargaining agreement with its union in Fairbanks should be permitted to have its right to reject that agreement determined under Second Circuit case law just because it is incorporated in New York or has a subsidiary that filed there first. Such was surely not within the reasonable expectation of the parties to the collective bargaining agreement when they executed it.

The law applicable to a debtor's bankruptcy case ought to be the law applicable in the state of its principle place of business, without an opportunity to choose other law.

As the Supreme Court stated in Gulf Oil Corp. v. Gilbert (1947), "In cases which touch the affairs of many persons, there is reason for holding the trial in their venue and reach rather than in remote parts of the country where they can learn of it by report only. There is a local interest in local controversies decided at home."

Venue Transfer Procedures Do Not Solve the Injustice of Law-Shopping
The opportunity for a change of venue does not solve the problem of law-shopping, for at least three reasons. First, as the ABI Commission found, "relatively few motions to transfer venue or to dismiss cases based on venue are filed." Experience further suggests that these motions are infrequently granted.

Second, these motions are expensive to litigate. Moreover, those expenses do not substantially contribute to the reorganization of the debtor's business. Reorganization is, after all, the goal of chapter 11.

Third, the Supreme Court has suggested, in Van Dusen v. Barrack (1964), that when venue is transferred, the law of the transferor circuit applies. It has held that following the transfer of a civil case at the request of the defendant, the transferee court must follow the choice-of-law rules that prevail in the transferor court. "The Supreme Court later held, in Feren v. John Deere Co. (1990), that the same rule applies even when the plaintiff has requested the transfer."

Chapter 11 venue reform is long overdue. The case for it is compelling. The ABI Commission to Study the Reform of Chapter 11 made a serious mistake in refusing to recommend this reform.

*Judge Steven Rhodes* presided over Detroit's landmark bankruptcy case. He is a long-standing member of the American Bankruptcy Institute and is a former member of its board of trustees and executive committee. He is about to retire after 30 years of service as a bankruptcy judge.
EXHIBIT A

28 U.S.C. §1408 should be amended as follows:

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

1) in which the domicile, residence, principal place of business in the United States, or principal assets in the United States, of the person or entity that is the subject of such case have been located for the one hundred and eighty days immediately preceding such commencement, or for a longer portion of such one-hundred-and-eighty-day period than the domicile, residence, or principal place of business, in the United States, or principal assets in the United States, of such person or entity were located in any other district; or

2) in which there is already pending a case under title 11 concerning such person's affiliate that directly or indirectly owns controls, is the general partner, or partnership holds 50 percent or more of the outstanding voting securities, of the person or entity that is the subject of such later filed case.

(b) For the purpose of this Section 1408, the domicile or residence of a person or entity other than an individual shall be the district in which such person or entity has its principal place of business or principal assets in the United States.