Former CLLA President Ivan Reich discusses Chapter 11 filing location issues — and what needs to change.

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MAKING THE CASE FOR BANKRUPTCY VENUE REFORM
Having served as president of the Commercial Law League of America this past year, I have had the opportunity to travel around the country and speak with fellow bankruptcy practitioners to discuss the issues they face in their local practices.

The number one concern I hear from my colleagues is that their business has been severely impacted by the fact that Chapter 11 filings are significantly down in their districts. The consensus is that this is in large part attributable to a steady trend over the past several years for debtors in Chapter 11 cases, most often at the behest of their secured lenders, to file cases in jurisdictions far removed from where the debtor principally conducts business or where its assets, employees and vendors are located.1

It is common knowledge that Delaware and the Southern District of New York are the intended beneficiaries of this large-scale national movement to forum shop the venue of Chapter 11 cases. The CLLA put this issue at the top of its legislative agenda.

Two summers ago, while then president-elect of the CLLA, I, along with current CLLA President Jeff Schatzman of Miami, had the opportunity to meet with the majority and minority staff and counsel of both the House and Senate Judiciary committees about what was then the Chapter 11 Bankruptcy Reform Act of 2011 (HR 2533), which proposed a change to the venue provisions of the U.S. Bankruptcy Code. The bill was introduced on July 14, 2011, in the U.S. House of Representatives by Representative Lamar Smith (R-Tex.) and cosponsored with Representatives Howard Coble (R-N.C.), Steve Cohen (D-Tenn.) and John Conyers, Jr. (D-Mich.). This bipartisan bill advanced venue reform by essentially eliminating state of incorporation for business filings in Chapter 11 cases and by restricting affiliate filings.

The current version of 28 U.S.C. § 14092 allows a Chapter 11 debtor three options for filing its case: 1) state of incorporation; 2) principal place of business; or 3) the location of its principal assets. In addition, almost any affiliate can join a pending Chapter 11 case. These venue choices were not always available. Between 1973 and 1978, the debtor’s place of incorporation was eliminated as a choice for venue. The 1978 Bankruptcy Reform Act changed that and returned place of incorporation as a venue option, which continues today. H.R. 2533 would have eliminated a debtor’s place of incorporation as a basis for venue. In addition, the reformed affiliate venue rule would have permitted the affiliates to file in a pending case only if the affiliate directly or indirectly owned or controlled more than 50 percent of the outstanding voting securities of such corporation. The reformed venue proposal essentially tracked the recommendations made by the National Bankruptcy Review Commission, which was authorized by Congress in 1994 to review and examine bankruptcy laws. The recommendations made by the commission have received wide support across the country, regardless of political and ideological viewpoints. I am proud that during my tenure as president of the CLLA, the Board of Governors of The Florida Bar, at the recommendation of its Business Law Section, and the Bankruptcy Bar of the Southern District of Florida both passed resolutions supporting the bankruptcy venue reforms set forth in then-H.R. 2533. Unfortunately, while favorably

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Shopping in the Bankruptcy Reorganization of Large, Publicly Held Companies, 1991, Wis. L. Rev. 11 (1991); (Professor LoBue and William Wiltz were the first to publicize the forum shopping phenomenon in bankruptcy and their empirical study of the 43 largest public companies to file under Chapter 11 between 1979 and 1986 concluded that a substantial number of these cases had been forum shopped).
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reported out of the House committee in a bipartisan manner, where all indications were that it would pass the full House in a similarly bipartisan manner, the bill lost traction when hurdles were placed in front of it on the Senate side from obviously affected interests from the states of Delaware and New York.

Since then, the CLLA has partnered with a group of practitioners from around the country to join forces in a national effort to change the bankruptcy venue statute. We are taking the long strategy since there are impediments to getting this done, but we are positioning ourselves to be ready when the opportunity presents itself. Our group so far has assembled a database of information on all Chapter 11 cases in Delaware from Dec. 1, 2003, the date PACER3 started, through Dec. 31, 2012, that should have been brought elsewhere if not for the current statute. We are in the process of developing a similar database for cases filed in the Southern District of New York.

This list is the most comprehensive list yet assembled. It represents 559 companies that brought Chapter 11 cases in Delaware but whose principal places of business were elsewhere, representing $529,478,098,007 in assets, $1,344,959,156,162 in liabilities, 3,156,984 creditors and 750,846 employees. Twenty-five companies from that list should have brought their cases in Florida before our courts (10 in the Southern District and 15 in the Middle District) during that time period. The list of Florida companies represents $5,526,973,043 in scheduled assets, $5,852,157,580 in scheduled liabilities, more than 24,008 employees and 139,957 creditors.

While the effect upon the local bankruptcy bar in losing these cases to these jurisdictions is important to practitioners, what is more important to legislators and the public at large is the fact that current venue rules have created problems that are adversely affecting the substantive rights of parties-in-interest — and are undermining the administration of Chapter 11 cases. These problems can be summarized as follows:

1. LIMITED ACCESS TO BANKRUPTCY COURTS

Due to the ability of a debtor to file for Chapter 11 protection in a jurisdiction remote from its principal place of business or its location of main business interests, locally based constituencies integral to the debtor’s business — such as state and local development agencies, local taxpayers, employees, vendors, retirees, customers and suppliers — are effectively disenfranchised, given their inability to bear the costs and inconvenience of (a) hiring counsel in a foreign jurisdiction to protect their interests and (b) participating in person in remote bankruptcy hearings.

By choosing (or sometimes being forced) to file a Chapter 11 case in a distant venue, the debtor is depriving local constituents of their due process. This situation is perhaps best exemplified by the case of Delphi, in which retirees in Michigan were disadvantaged by the distance they had to travel to have input in the case, which was handled in New York. In particular, at Delphi’s confirmation hearing in New York, only one retiree located in Michigan participated in the hearing, and his participation was by telephone. There is no record of any employees participating in person at the confirmation hearing. Had the bankruptcy case been administered closer to Delphi’s center of business contacts, the retirees could have had much more of a presence, thereby better enabling their rights to be protected in connection with Delphi’s complex confirmation hearing. By enabling Chapter 11 debtors to file in remote courts, certain parties-in-interest may have effectively been denied access to the bankruptcy process.

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3 Section 1408. Venue of cases under Title 11.
4 The principal place of business in the United States of a person or entity that is the subject of such case has been located for the period of one hundred and eighty days immediately preceding such commencement, or for a longer period of such one hundred and eighty day period than the debtor, residence, principal place of business, in the United States, or principal assets in the United States, of such person were located in any other district.
5 In which the principal place of business in the United States of a person or entity that is the subject of such case has been located for a longer period of one hundred and eighty days immediately preceding such commencement, or for a longer period of such one hundred and eighty day period than the debtor, residence, principal place of business, in the United States, or principal assets in the United States, of such person were located in any other district.
6 In which the principal place of business of the United States of a person or entity that is the subject of such case has been located for a longer period of one hundred and eighty days immediately preceding such commencement, or for a longer period of such one hundred and eighty day period than the debtor, residence, principal place of business, in the United States, or principal assets in the United States, of such person were located in any other district.

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2. THE NEW YORK-DELWARE DUOPOLY ON CHAPTER 11 JURISPRUDENCE VIOLATES CITIZEN ACCESS AND FEDERALISM PRINCIPLES.

The current venue rules have effectively enabled two courts, the Southern District of New York and Delaware, to control the creation and evolution of Chapter 11 jurisprudence. This is most certainly an unintended consequence of the lax venue rules. Nowhere in the 1978 Code is there any discussion that Chapter 11 cases should only be administered in certain jurisdictions. The code provides for a national bankruptcy court system, and yet Chapter 11 case precedent is largely concentrated in a duopoly comprising the Southern District of New York and Delaware bankruptcy courts. The federal judicial system as a whole and the evolution of the law benefit from the input of judges from multiple jurisdictions, which over time reach a consensus.

The requirements of our federal system are being ignored. Federal district courts and bankruptcy courts were established in each state to provide direct access by citizens and to support principles of federalism. These principles should be respected, not overridden as they are now by lax venue rules that give free reign to excessive forum shopping by case placers.

3. THE ADMINISTRATION OF A CHAPTER 11 DEBTOR AFFECTS LOCAL COMMUNITIES.

The Bankruptcy Code is not purely economic legislation, and the bankruptcy court is not merely a commercial court; the law is socioeconomic, and courts are required to balance the interests of many different parties. By allowing Chapter 11 debtors to engage in excessive远程 and remote forum shopping, the social effects of the administration of a bankruptcy case are being neglected.

An entire community may be affected by the bankruptcy of a homegrown business, but if it is administered in another state, a judge unfamiliar with the significance and nuances of the business may not appreciate all of the local community’s concerns. This point is compounded by the fact that many local constituents are not in a position to advocate in distant jurisdictions. An example of constituency disenfranchisement is the Harry & David Chapter 11 case. Harry & David was a family-owned Medford, Ore., business — that is, until private equity money purchased the company in 2004 and leveraged the company with debt. When it filed in 2011, it filed in Delaware, and lifelong employees and retirees whose pensions were gutted by the Chapter 11 sale effectively had no voice in the bankruptcy process. The paradigm case is Patriot Coal, in which West Virginia miners objected to the bankruptcy filing occurring in New York. While it is true that current law allows for a change of venue, as it did ultimately in this case, such changes occurred only after a huge effort and many hundreds of thousands of dollars spent in legal fees. Obtaining venue change is often a hollow victory. Indeed, in the Houghton Mifflin case, another case involving venue change, the transfer of the matter to Boston occurred only after the plan was confirmed, a year after the case was filed in New York with absolutely no legal basis for the original venue choice. More often than not, cases are administered in courts located in communities with zero connection to the Chapter 11 debtor.

By concentrating Chapter 11 cases in two jurisdictions that are the home to only the financial services industry, courts over time become less sensitive to the impact they have on other stakeholders such as employees, retirees, vendors and the community. This is not to say that bankruptcy judges are biased, only that they are human. When only the financial stakeholders are appearing at important hearings, their voices drown out those of the other constituents that cannot afford to participate actively in a case filed thousands of miles away.
4. BALANCED BARGAINING POWER DRIVES SETTLEMENT AND CONSENSUS.
Current venue rules result in the same judges handling a majority of the cases, which effectively ensures certain outcomes, favoring certain parties over others and empowering them to resist bargaining, because they have reason to be confident of victory. Uncertainty and more equal bargaining positions can promote a willingness to compromise and can lead to an optimal outcome, whether it is a reorganization that more fairly distributes enterprise value or a sale process that drives up the ultimate price paid for a debtor’s assets.

5. ADMINISTRATION EXPENSES INCURRED BY LEGAL AND FINANCIAL PROFESSIONALS HAVE SKYROCKETED.
According to major studies, the concentration of Chapter 11 cases in New York and Delaware has resulted in a sharp increase in the costs of administration, namely fees incurred by legal and financial advisors. New York rates, in particular, are the highest in the country. Attorneys outside of the large cities generally charge lower rates for their legal services, thereby reducing the overall costs of administering a case in Chapter 11 and enabling certain debtors — for whom a bankruptcy filing in New York or Delaware is cost-prohibitive — to have an opportunity to access the Chapter 11 process and reorganize instead of liquidate. Moreover, where creditors and others are represented by their regular counsel from elsewhere in the country, Delaware local rules requiring attendance and participation by local counsel at all times create unnecessary duplication and impose unnecessary costs. As such, because local rules are drafted in consultation with and directly benefit the local bar, it can be expected to resist any relaxation in these requirements.

6. DISTRESSED MERGER AND ACQUISITION VS. REORGANIZATION
Chapter 11 is not working as well as it did when companies filed locally. Quick bankruptcy asset sales are more common than reorganization plans. More reorganization plans fail, usually due to over-leveraging, resulting in more repeat filings (so-called “Chapter 22s”) than ever before. Local case venues would be more likely to result in more concern for preservation of the ongoing business and the preservation of jobs, in a pragmatic environment that takes into account local factors and can gain local support. The Bankruptcy Code should be focused on the reorganization of viable businesses, not just the sale of their assets.

7. THE LOCAL ECONOMY PAYS A PRICE DUE TO VENUE CONSOLIDATION.
Last, and perhaps not least, the concentration of Chapter 11 cases in one or two jurisdictions deprives local hospitality and service providers from sharing in the economic activity that surrounds these cases. This activity includes not just local lawyers, but also hotels, restaurants, cabs and copy centers, to name a few. To convey some sense of the magnitude of the amount at issue, sources estimate that the economic boost to Wilmington, Del., from all the bankruptcy cases that are filed there is as much as $100 million each year.

To lay the groundwork for future legislation, our working group is in the process of assembling real stories demonstrating how the current venue rules have harmed parties in interest. As you read this article, think about cases that should have been filed in the jurisdiction where you practice, and instances of where you represented a party (employees, retirees, vendors, state agencies, creditors or other parties) that (a) elected not to oppose something in the case; (b) was negatively impacted by a decision in Delaware or New York that your client could not afford to oppose in a faraway jurisdiction; (c) chose to settle instead of litigate because the bankruptcy case was filed in a faraway venue; or (d) was impacted by those courts approving insider bonuses, sales or treatment of claims without opposition.

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