

THE WALL STREET JOURNAL.

This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers visit <http://www.djoprnts.com>.

<http://blogs.wsj.com/bankruptcy/2015/02/09/the-baffling-rejection-of-venue-reform-by-the-abi-chapter-11-reform-commission/>

BANKRUPTCY BEAT | COMMENTARY

The Baffling Rejection of Venue Reform by the ABI Chapter 11 Reform Commission

By STEVEN RHODES

Feb 9, 2015 1:19 pm ET

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.



Judge Steven Rhodes JOHN MEIU/ASSOCIATED PRESS

WSJ PRO
CENTRAL BANKING
NEWSLETTER

WSJ PRO PROMOTION



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 *Ferens 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.

Share this: <http://on.wsj.com/1CbeTBX>

Copyright 2014 Dow Jones & Company, Inc. All Rights Reserved

This copy is for your personal, non-commercial use only. Distribution and use of this material are governed by our Subscriber Agreement and by copyright. For non-personal use or to order multiple copies, please contact Dow Jones Reprints at 1-800-843-0008 or visit www.djreprints.com.

WSJ PRO
CENTRAL BANKING
NEWSLETTER

WSJ PRO PROMOTION