

# NABTALK®

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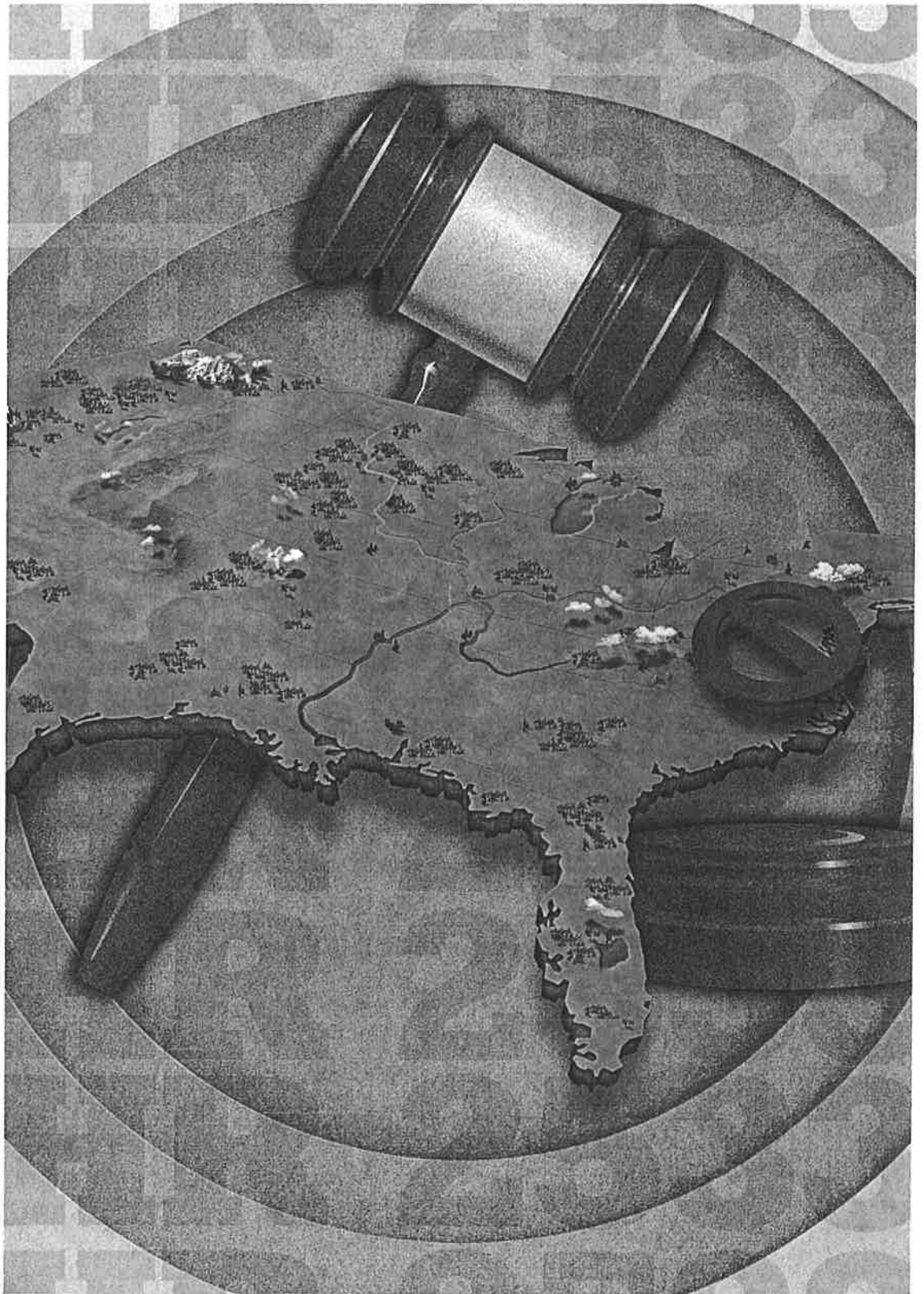
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**BANKRUPTCY  
VENUE -  
CURRENT  
LAW IS  
GOING,  
GOING,  
GOING...  
GONE?**

Peter C. Califano

Congress is now on the verge of the most significant bankruptcy reform in nearly 35 years, that if passed, will absolutely impact the practice of bankruptcy throughout the country for the courts, trustees, debtors, creditors and all the other professionals who assist in reorganizing businesses through Chapter 11 cases. The issue concerns where the debtor is allowed to file its bankruptcy case. A bill is now pending proposing to change the permissive venue options contained in the Bankruptcy Code, and its outcome should be everyone's concern. This article will provide an overview of the history, the pros and cons for reform and why the proposed venue statute would ultimately benefit the practice of bankruptcy.

### Background and History

The Chapter 11 Bankruptcy Reform Act of 2011 ("HR 2533") was introduced on July 14, 2011 in the United States House of Representatives by Representative Lamar Smith (R-TX) and co-sponsored with Representatives Howard Coble (R-NC), Steve Cohen (D-TN), and John Conyers, Jr. (D-MI) proposing a change to the venue provisions of the US Bankruptcy Code. This bipartisan bill advances venue reform by essentially eliminating state of incorporation for business filings in Chapter 11 cases and restricts affiliate filings.<sup>1</sup>

The current version of 28 USC Section 1408 allows a Chapter 11 debtor three options for filing its case: state of incorporation, principal place of business, or the location of its principal assets.<sup>2</sup> In addition, almost any affiliate can join a pending Chapter 11 case.<sup>3</sup> These venue choices were not always available. Between 1973 and 1978, the debtor's place of incorporation was eliminated as a choice for venue.<sup>4</sup> The 1978 Bankruptcy Reform Act changed that and added back in incorporation as a venue option, which remains as of today.<sup>5</sup>

HR 2533 would eliminate a debtor's place of incorporation as a basis for venue. In addition, the reformed affiliate venue rule would permit the affiliates to file in a pending case only if the affiliate directly or indirectly owned or controlled more than 50% of the outstanding voting securities of such corporation.<sup>6</sup> The reformed venue proposal essentially tracks the recommendations made by the National Bankruptcy Review Commission which was authorized by Congress in 1994 to review and examine bankruptcy laws.<sup>7</sup> The recommendations made by the Commission have received wide support across the country regardless of political and ideological viewpoints.

### Pros and Cons of HR 2533

On September 8, 2011, hearings were held before the Subcommittee on Courts, Commercial and Administrative Law at the Committee of the Judiciary of the United States House of Representatives on HR 2533.<sup>8</sup> Testifying in support of the bill was the Honorable Frank J. Bailey, Chief Judge, United States Bankruptcy Court, District of Massachusetts; Melissa B. Jacoby, Law Professor, University of North Carolina at Chapel Hill; and Peter C. Califano, a San Francisco bankruptcy practitioner and as Chair of the Bankruptcy Section of the Commercial Law League of America (the "CLLA"). In opposition to the bill, David A. Skeel, Jr., Law Professor, University of Pennsylvania Law School. Below is a summary of the main points of each witness discussing the pros and cons for HR 2533.

#### A. Honorable Frank J. Bailey

Judge Bailey noted that the venue statutes had "simply not worked out the way Congress intended". Due to the overly permissive venue statute of Section 1408, there has been an unexpected distribution of large bankruptcy cases to New York and Delaware based on the convenience of the debtor, its counsel, and large financial institutions. This distribution has unfortunately been at the expense of small creditors, vendors, employees and pensioners. The *Polaroid* (U.S. Bankruptcy Court, District of Delaware, Case No. 01-10864) and *Evergreen Solar* (U.S. Bankruptcy Court, District of Delaware, Case No. 11-12590) bankruptcy cases were used as examples of filings made in Delaware instead of Massachusetts where local creditors and interests suffered due to the filing in a remote court. In closing, Judge Bailey discussed at length the competency and professionalism of the bench in Massachusetts and in other states, being entirely capable and equal to the task of handling "mega-cases".<sup>9</sup>

#### B. Professor Melissa Jacoby

Professor Jacoby noted that since 2005 nearly 70% of the 200 large public companies that have filed bankruptcy have filed their cases in either Delaware or New York using the current venue law. Although some of the companies were headquartered in New York, most were not. Also it was noted that the present bankruptcy venue law is at odds with other venue statutes, e.g., plaintiffs in civil cases are not permitted to initiate an action in their state of incorporation thereby forcing a party to appear in that forum to address claims. On another important point, supporters of the existing venue scheme often argue that eliminating state of incorporation for venue will not actually create venue that is more convenient for creditors and other stakeholders than existing current law. The Delaware State Bar Association raised a similar critique in 1996 with the National Bankruptcy Review Commission. The Commission studied the extensive arguments and information provided by the Delaware State Bar and still found that "disenfranchisement of creditors due to a bankruptcy filing in an inconvenient forum was the single most cited reason in favor of a proposal to amend the venue provisions".<sup>10</sup>

#### C. Professor David Skeel

Professor Skeel argued that it would be a mistake to overturn the long history of bankruptcy practice with the current venue statute. He claimed that it would undermine the effectiveness of the corporate bankruptcy system, increase administrative cost within the system and not help the parties that HR 2533 was ostensibly designed to help. He noted the expertise of the bench, innovations and speed of the courts in Delaware and New York have attracted large cases to these locations. Professor Skeel also noted that creditors always have the right to transfer cases filed in

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#### About the Author

Mr. Califano is a partner of the San Francisco law firm of Cooper, White & Cooper LLP and since 1987 has represented numerous creditors and trustees in all aspects of bankruptcy and insolvency-related matters. He is currently the Chair of the Bankruptcy Section of the Commercial Law League of America and has led its legislative efforts since 2005. He is also actively involved in various California-based bankruptcy and insolvency organizations and a frequent writer and speaker on these topics.

the wrong venue, that technology has allowed greater out-of-town participation in proceedings in Delaware and New York, and finally noted that availability of traditional and special committees to represent collective interest ensure that all parties have an ability to effectively provide input into a bankruptcy case.<sup>11</sup>

### **An Interview with Peter Califano**

Mr. Califano was the only practitioner who testified at the September 8th hearing.<sup>12</sup> His contributions to the venue debate are highlighted in an interview with the Editor of *NABTalk*, E. Lynn Schoenmann, as follows:

**SCHOENMANN: Q.** *How did you get selected to testify at the venue hearing?*

**CALIFANO: A.** Interestingly, the CLLA, which has been active on Capitol Hill for years, had a Hill Day the month before the hearings where a group of us had met with both Democrat and Republican staff members in the House and the Senate to discuss various “critical” bankruptcy issues. One of those issues concerned the need for venue reform, which the CLLA has historically supported. In fact, I had signed the CLLA’s letter in support of the venue reform bill proposed by Senator John Cornyn (S. 314 as the Fairness in Bankruptcy Litigation Act) back in 2005. So when the venue panel was put together, our discussions were still fresh in everyone’s mind.

**SCHOENMANN: Q.** *You stated at the hearing that “bankruptcy is local”. What did you mean by that and how does that impact venue?*

**CALIFANO: A.** The consequences of a corporate bankruptcy are most profound in the region and community in which the debtor’s principal place of business or principal assets are located. Not only are there jobs involved, but also the local economy might depend, to a large extent, on business from that debtor. Many critical issues of local importance arise. The debtor may be, for example, one of the community’s larger employers or it may sustain many small businesses that provide various goods and services to it. The consequences could extend even further affecting the number of, for example, hospital beds that are available, the quality of elder care, or even hazardous waste removal. These are just a few of the countless local issues that might be engaged and will require local subject matter expertise with respect to real property, local taxes, environmental, or health and safety issues, as examples.

**SCHOENMANN: Q.** *So what are the downsides of filing in a remote bankruptcy court?*

**CALIFANO: A.** It has been my and others experience that bankruptcies filed in remote jurisdictions draw cases away from the parties with the most familiarity with the debtor’s operations and those who have an important stake in the case’s outcome. For example, employees, local vendors, and retirees will often be unable to attend hearings without incurring insurmountable time and travel expenses. There will also be little or no local media coverage on the progress of the debtor’s efforts to reor-

ganize and the participation of creditors and stakeholders will wane. Practitioners know that quite often these interested parties will go down to the local bankruptcy court and meet other similarly situated parties, share information, and develop alliances and informal groups to protect their interests. Ultimately, these efforts might impact official or unofficial committees in the case and even have a direct impact on the provisions of the plan of reorganization. However, if the bankruptcy is pending in a location thousand of miles away, these parties will not be able to take advantage of this informal networking and their contribution will be lost or minimized.

**SCHOENMANN: Q.** *What is your response to the claim that bankruptcy courts outside of Delaware and New York are ill-equipped or unable to handle a large mega case?*

**CALIFANO: A.** Three letters, “PG&E”. As you recall, this case was filed in the Northern District of California in 2001 (Case No. 01-30923) and at the time was the largest utility bankruptcy cases ever to be filed (\$35 billion in assets and approximately 20,000 employees). Judge Dennis Montali, who oversaw the case, organized his court and calendar to efficiently administer this “mega-case” resulting in a confirmed plan and a successfully reorganized debtor. There is no doubt that Delaware and New York have expertise to handle mega bankruptcy cases but the PG&E case proves other courts around the country, if given the chance, have the ability and skill to handle these types of cases.

**SCHOENMANN: Q.** *Any other advantages about having a local bankruptcy court involved?*

**CALIFANO: A.** Plenty. There are many examples where access becomes critical to the resolution of a bankruptcy case. In preparing for the hearings, I came across a case that unfortunately I did not have time to discuss during my testimony. That case was *Franklin Park Development I, Inc.* (U.S. Bankruptcy Court, District of Massachusetts, Case No. 86-10721) where Judge Livien presided over a bankruptcy of a housing project, primarily for lower income renters, comprised of hundreds of units and perhaps over a thousand residents. The judge along with the trustee visited the property and received significant local press coverage. Apparently, through the judge’s personal attention, it helped defuse a seriously and emotionally charged situation. The involvement of the local bankruptcy judge provided invaluable comfort to those affected and led to a positive outcome of the case. And I’m sure there are hundreds of other anecdotes where the local courts, trustees, lawyers, and bankruptcy professionals greatly impact and help resolve cases on a daily basis throughout the country.

**SCHOENMANN: Q.** *How do you respond to the allegation that isn’t this just about the lawyers from one part of the country trying to grab a bigger share of bankruptcy cases (and thus fees) from Delaware and New York?*

**CALIFANO: A.** There is no doubt that there are huge financial consequences regarding bankruptcy venue. Right after the venue hearings, *Bloomberg Businessweek* published a report (February 12, 2012) that the change in the venue law could cost

the Delaware economy, i.e. hotels, restaurants, taxicabs, car rentals upwards of \$100 million a year if bankruptcy cases were filed in other districts. The estimate for New York was \$190 million. Being a host to a mega bankruptcy case is akin to having a convention in your city with all the related economic activity. And this is in addition to all the professional fees that are required to reorganize the Chapter 11 debtor. But that's not all that's at stake. As mentioned in the National Bankruptcy Review Commission's report, disenfranchisement of creditors was the main concern that the Commission had for reforming venue in bankruptcy. It ties in with our system of democracy where court proceedings are visible and reported in the local media and ordinary citizens can attend and view the proceedings. It goes to the heart of the integrity of the bankruptcy system. Admittedly, financial considerations are important, but really not the most important concern regarding this matter.

**SCHOENMANN: Q.** *What is the current status and future of HR 2533 and its likely outcome?*

**CALIFANO: A.** Given the election coming up in November, I understand that it's unlikely that this bill will move out of Committee. However, in the interim, many local and state bar associations across the country, along with various trade groups have or are in the midst of writing letters in support of HR 2533. Senators and representatives are being contacted and encouraged to co-sponsor and/or signal their support the bill. I am hoping for the bill to move out of Committee after November and available for a vote maybe early next year.

### Conclusion

HR 2533 will result in a better distribution of Chapter 11 cases across the country. This in turn will empower local courts, trustees, debtors, creditors and all the other professionals in

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**HR 2533 will result in a better distribution of Chapter 11 cases across the country. This in turn will empower local courts, trustees, debtors, creditors and all the other professionals in solving economic problems of the businesses and other institutions most relevant to them...The result should be a better reorganization process and results.**

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solving economic problems of the businesses and other institutions most relevant to them. The result should be a better reorganization process and results. Large debtors and financial institutions, with their counsel and professionals, will continue to be able to lead and participate in bankruptcy cases, wherever filed. To be sure, there will be litigation to further clarify the more limited venue choices of principal place of business or the location of the principal assets proposed under HR 2533, but it is certain that the resulting venue will bring bankruptcy cases closer to the communities and regions where the debtor's operations are most relevant. Isn't that a good thing for the practice of bankruptcy and the country as it shakes off the effects of the Great Recession? 🏠

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### EXHIBIT A

#### Redline of 28 USC § 1408 as modified by HR 2533

#### § 1408. Venue of cases under title 11

(a) Except as provided in section 1410 of this title and subsection (b) of this section, a case under title 11 may be commenced 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 were located in any other district; or

(2) in which there is pending a case under title 11 concerning such person's affiliate, general partner, or partnership.

(b) A case under chapter 11 of title 11 in which the person that is the subject of the case is a corporation may be commenced only in the district court for the district—

(1) in which the principal place of business in the United States, or principal assets in the United States, of such corporation have been located for 1 year immediately preceding such commencement, or for a longer portion of such 1-year period than the principal place of business in the United States, or principal assets in the United States, of such corporation were located in any other district; or

(2) in which there is pending a case under chapter 11 of title 11 concerning an affiliate of such corporation, if the affiliate in such pending case directly or indirectly owns, controls, or holds with power to vote more than 50 percent of the outstanding voting securities of such corporation.

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#### Footnotes:

<sup>1</sup> See, Exhibit A below for proposed revised 28 USC § 1408.

<sup>2</sup> 28 USC § 1408(1).

<sup>3</sup> 28 USC § 1408(2).

<sup>4</sup> National Bankruptcy Review Commission Final Report, pp. 766-768 (1997).

<sup>5</sup> *Id.*

<sup>6</sup> See, Exhibit A.

<sup>7</sup> National Bankruptcy Review Commission Final Report Section pp. 765-780.

<sup>8</sup> See, Chapter 11 Bankruptcy Venue Reform Act of 2011, Hearing Before the Subcommittee on Courts, Commercial and Administrative Law of the Committee on the Judiciary, House of Representatives, 112th Congress, First Session on H.R. 2533, September 8, 2011, Serial No. 112-88, [http://judiciary.house.gov/hearings/printers/112th/112-88\\_68185.PDF](http://judiciary.house.gov/hearings/printers/112th/112-88_68185.PDF).

<sup>9</sup> *Id.*, pp. 32-56.

<sup>10</sup> *Id.*, pp. 59-68.

<sup>11</sup> *Id.*, pp. 23-29.

<sup>12</sup> *Id.*, pp. 11-19.