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New Venue Legislation Seeks to Prevent "Forum-Shopping" in Chapter 11 Cases

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The appropriate venue for chapter 11 cases has long been the subject of debate, especially over the past decade. The debate's most recent development is the Chapter 11 Bankruptcy Venue Reform Act of 2011 ("H.R. 2533"), introduced on July 14, 2011, by Representatives Lamar Smith of Texas, John Conyers, Jr. of Michigan, Howard Coble of North Carolina, and Steve Cohen of Tennessee (collectively, the "Sponsors").[1] H.R. 2533 proposes changes to the current venue rules to limit "forum-shopping" by potential debtors; [2] however, H.R. 2533 may have unintended consequences that negatively affect all parties-in-interest in a chapter 11 case.

Below is a synopsis of the current rules on bankruptcy venue, the changes proposed by H.R. 2533, and the potential effects of this legislation.[3]

EXISTING VENUE PROVISIONS

28 U.S.C. section 1408 of the United States Code ("section 1408") governs venue in chapter 11 cases. As currently written, section 1408 provides that a debtor may file its bankruptcy case (i) in any district court where the debtor's domicile, residence, principal place of business, or principal assets are located, or (ii) in any district court where an affiliate, general partner, or partnership of the debtor has a case pending. Under the current rule, many companies are eligible to, and do, file their bankruptcy cases in either the Southern District of New York or the District of Delaware, often because these companies are either incorporated or have the requisite assets located in these jurisdictions, or can follow affiliates that can file there into bankruptcy.

H.R. 2533 PROPOSES CHANGES TO THE CURRENT VENUE RULES TO LIMIT "FORUM-SHOPPING" BY POTENTIAL DEBTORS; HOWEVER, H.R. 2533 MAY HAVE UNINTENDED CONSEQUENCES THAT NEGATIVELY AFFECT ALL PARTIES-IN-INTEREST IN A CHAPTER 11 CASE.

The current venue rules also allow for the transfer of a bankruptcy case following its commencement if the venue is found to be improper or for other reasons even if the venue is proper. 28 U.S.C. section 1412 ("section 1412"), provides that "[a] district court may transfer a case or proceeding under title 11 to a district court for another district, in the interest of justice or for the convenience of the parties." A request to transfer venue may be made by a party-in-interest or by the court.

[1] The complete text of H.R. 2533 can be found at: http://judiciary.house.gov/hearings/pdf/HR%202533.pdf.

[2] H.R. 2533 is not the first bill of its kind. In 2005, Senator John Cornyn (R-TX) proposed the Fairness in Bankruptcy Litigation Act of 2005, which, much like H.R. 2533, sought to prevent forum-shopping by potential debtors. Senator Cornyn's proposal never advanced beyond the Senate Judiciary Committee.

[3] At present, H.R. 2533 has been referred to the House Committee on the Judiciary, but has not yet been the subject of a vote. A companion bill has not been presented to the Senate.

CHANGES PROPOSED BY H.R. 2533

The stated purpose of H.R. 2533 is to ensure that bankruptcy cases are commenced in the jurisdictions that—based upon the company's actual creditors or operations and assets—would be most likely to allow the most creditors the best opportunity for participation in the bankruptcy process. H.R. 2533 provides revisions to section 1408 in a perceived attempt to promote fairness by helping to ensure maximum stakeholder participation in chapter 11 cases. Specifically, H.R. 2533 seeks to revise section 1408 to provide that "(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."

By seeking to require a chapter 11 debtor to file a bankruptcy petition in the district where either the debtor's principal place of business or principal assets are located, the Sponsors seek to avoid future chapter 11 filings in jurisdictions where a particular debtor has little or no financial presence or activities (e.g., employees, assets, and/or creditors).

In support of the legislation, the Sponsors reference the chapter 11 cases of Enron and General Motors (both of which were filed in the Southern District of New York), in which those corporations chose to file their bankruptcy petitions in jurisdictions where, although the main debtor entities had the requisite connections, such jurisdictions were not the debtor entities' primary place of business.

PRACTICAL CONSIDERATIONS AND UNINTENDED CONSEQUENCES OF H.R. 2533

The Sponsors of H.R. 2533 seek to prevent what they perceive is inappropriate forum-shopping in chapter 11 cases; however, the effect of the bill, although well intentioned, may be to limit venue in a way that harms debtors and creditors alike.

Maximum creditor participation is important to a fair and effective chapter 11 process, which allows creditors to participate in a variety of ways in addition to direct individual participation. For example, the statutory committee of unsecured creditors in a chapter 11 case acts as a fiduciary for all unsecured creditors and ensures that unsecured creditors have a powerful voice in the case. Similarly, in certain cases where employee interests may be impaired, employees' interests may be represented not only by the official committee of unsecured creditors, but also through the involvement of unions and quasi-governmental agencies such as the PBGC.

The Bankruptcy Code and related laws provide certain creditor protections to promote maximum participation in a bankruptcy case, including, but not limited to, the ability to transfer venue if the chosen bankruptcy venue is found to be inimical to creditor participation. As noted above, a party-in-interest, or the court itself, may make a motion to transfer venue "in the interest of justice or for the convenience of the parties."

Indeed, venue transfer motions have been considered in many chapter 11 cases, typically upon the request of creditors. Certain courts faced with the delicate balancing of interests at stake in these cases have ruled in favor of transferring venue where creditors preferred a case to be administered in the debtor's home jurisdiction. Examples include the chapter 11 cases of *Dunmore Homes* and *Winn-Dixie*.

Moreover, creditors who believe a debtor's venue choice to be inappropriate are already afforded statutory protection to challenge the debtor's chosen jurisdiction. In that regard, H.R. 2533 may be seeking to afford protections to creditors that already exist under the current statutory provision for venue transfer. And, to the extent creditors may disfavor the narrow venue rules proposed by H.R. 2533, they may still rely on section 1412 to transfer a chapter 11 case from a debtor's home jurisdiction to New York or Delaware (assuming it is more convenient for the parties). This result, if sanctioned by the bankruptcy court, would eviscerate the intended effect of the legislation and lead to unnecessary inefficiency and delay in the administration of chapter 11 cases.

H.R. 2533 MAY BE SEEKING TO AFFORD PROTECTIONS TO CREDITORS THAT ALREADY EXIST UNDER THE CURRENT STATUTORY PROVISION FOR VENUE TRANSFER.

It is also worth noting that it is not a foregone conclusion that creditors would prefer to participate in a chapter 11 case in the jurisdiction in which the debtor has a major presence. Given the national and international scope of many of today's largest corporations, major stakeholders are often not located near the headquarters or principal place of business of a debtor, but rather are scattered across the United States and overseas. Although each chapter 11 case is unique, there are typically a wide range of interests at stake, including employees, trade creditors, secured lenders, bondholders, and shareholders, among others. It is possible that the interests of a select subset of creditors may be best served by a chapter 11 filing in a debtor's home jurisdiction; but that subset's preferences and interests may conflict with those of other creditors. Therefore, to ensure the maximum participation by the greatest number of creditors—which the Sponsors have stated as a goal of H.R. 2533—the interests of the *entire* creditor body must be evaluated. On the whole, a majority of creditors may prefer to be in mega-case jurisdictions such as the Southern District of New York or the District of Delaware, not only for the perceived benefits of efficient case administration and expertise, but also for convenience.

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Parties-in-interest in a chapter 11 case may also disfavor the narrow venue rules proposed by H.R. 2533 if there is a particular legal precedent in a debtor's home jurisdiction that is unfavorable. A notable example of this concern is illustrated by the *K-mart* chapter 11 case, in which the debtor was forced to sue hundreds of vendors to claw back critical vendor payments that were found on appeal to be unauthorized—such result may have been different in other venues. Similarly, the Third Circuit precedent established in *In re Visteon Corp*., which requires a debtor to comply with the bankruptcy statute governing payment of insurance benefits to retirees before terminating such benefits regardless of contractual language that may otherwise allow for termination by the debtor, may be thought to create a more favorable venue for retirees than other jurisdictions that hold that a debtor does not need to comply with the applicable bankruptcy statutes when such debtor has a prepetition contractual right to terminate benefits at will. Thus, limiting the venue alternatives as proposed by H.R. 2533 may force a debtor to commence a chapter 11 case in a jurisdiction that has unfavorable or undeveloped law on an issue that could lead to poor outcomes for creditors and other constituents.

IF CONGRESS WANTS TO REALLOCATE THE BALANCE OF BANKRUPTCY FILINGS THEN THEY SHOULD ALSO BE PREPARED TO ALLOCATE RESOURCES TO OTHER JURISDICTIONS THAT WILL NOW BE SUBJECT TO ADDITIONAL, AND POSSIBLY "MEGA," BANKRUPTCY FILINGS.

Lastly, if Congress wants to reallocate the balance of bankruptcy filings then they should also be prepared to allocate resources to other jurisdictions that will now be subject to additional, and possibly "mega," bankruptcy filings. For example, the chapter 11 bankruptcies of large corporate debtors often involve a greater number of creditors and, consequently, a higher volume of motion practice and claims against the estate. This increased level of participation in a bankruptcy case may result in a need for certain jurisdictions to enhance the number of judicial clerks and clerical staff, as well as prepare for increases in overhead costs—factors that the current mega-case jurisdictions are already designed to address.

CONCLUSION

The appropriate venue for chapter 11 cases should not be viewed in a vacuum. The current law on venue, as written and as it has evolved in the courts, provides a certain level of flexibility for debtors, while granting protections for creditors in the event venue choices are abused. H.R. 2533 proposes to change the current venue landscape without a comprehensive evaluation of how such changes may harm the very parties that the Sponsors are seeking to protect. Before enacting any such legislation, Congress should consider the unintended consequences that this legislation may have on all the different stakeholders in chapter 11 cases.

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