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Home Alone: Considerations on Efforts to Limit Venue

By Brian F. Moore*

In this article, the author recommends that advisors to debtors should continue to advise their clients to avail themselves of all options presented by venue choices, and that reformers should take into consideration that there may be a downside to venue restrictions.

Bankruptcy forum shopping – a debtor's selection of the venue within which to commence a voluntary bankruptcy case utilizing the options set forth in 28 U.S.C.A. § 1408 – has been perceived as a scourge of the bankruptcy system for years.[1] In that connection, Representatives Ken Buck of Colorado and Zoe Lofgren of California recently re-introduced legislation, the "Bankruptcy Venue Reform Act," H.R. 1017, with the stated goal to ensure that the employees, small businesses, and local communities that are most impacted by a Chapter 11 bankruptcy are "fully and fairly" able to participate in bankruptcy proceedings.[2] In so doing, Representative Buck commented that:

> [u]nder current U.S. law, corporations filing Chapter 11 bankruptcy have the ability to "venue shop" and potentially choose a court that has issued lenient rulings in similar cases. Our bill will require corporations filing Chapter 11 bankruptcy to go through those proceedings in the forum they are primarily located rather than running off to a court across the country. This will eliminate companies' ability to tilt the scale of justice and ensure the case is heard in a court familiar with all the affected stakeholders.[3]

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1 See Laura N. Coordes and Joan N. Feeneyase, Why Bankruptcy Venue Reform Now? Norton Bankr. L. Adviser, 2021 No. 12 (Advocating that Congress and courts should act to ensure that debtors and their professionals are prohibited from manipulating venue choices and judge assignment procedures to turn judges into instruments for achieving their clients' particular goals and case outcomes), https://www.americancollegeofbankruptcy.com/file.cfm/29/docs/norton%20bankruptcy%20law%20adviser%20-%20why%20bankruptcy%20reform%20now.pdf.

2 Press Release, Lofgren, Buck Reintroduce Bipartisan Legislation to End Corporate Bankruptcy Forum Shopping, February 14, 2023, https://lofgren.house.gov/media/press-releases/lofgren-buck-reintroduce-bipartisan-legislation-end-corporate-bankruptcy-forum.

3 Id.

EXISTING LAW

Currently, corporations can commence a bankruptcy case in any district "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."[4] Were the Bankruptcy Venue Reform Act enacted, it would limit where a corporation can file for bankruptcy protection to the district court in which the principal place of business (i.e., the company's headquarters) is located.

In turn, the proposed reform would eliminate the alternative venue provisions – specifically, domicile or residence, that corporations have utilized to "forum shop" and select a venue that is deemed to be most favorable based on applicable case law and procedures, or even particular judges.[5] More often than not, this has resulted in corporations' decisions to file in the Southern District of New York or in Delaware,[6] with more than 60% of large firms in recent years choosing to file bankruptcy cases in just these two venues,[7] relying, for instance, solely on an entity's (or its affiliate's) state of incorporation or residence to access a particular bankruptcy court.

CRITICISMS

Advocates for venue reform, such as Senator Elizabeth Warren of Massachusetts[8] and the current co-sponsor Representative Lofgren, see this as abuse, with Representative Lofgren decrying it is "simply unfair that corporations can game the bankruptcy system by choosing a distant court where there is a cottage industry to advantage their interest."[9] Instead, in their view, "[j]ustice is best

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[4] 28 U.S.C.A. § 1408 - Venue of cases under title 11.

[5] Parker Reynolds, Is the Corporate Forum Shopping Spree Coming to an End? Am. U. Bus. L. Rev. https://aublr.org/2021/10/is-the-corporate-forum-shopping-spree-coming-to-an-end/.

[6] Jared A. Ellias, Bankruptcy Law: Explaining Bankruptcy Forum Shopping, The Judges' Book: Vol. 3, Article 5. (2019), https://repository.uchastings.edu/judgesbook/vol3/iss1/5.

[7] See Samir D. Parikh, Modern Forum Shopping in Bankruptcy, 46 Conn. L. Rev. 159, 193-96 (2013) (report finding that 80% of corporations utilized forum shopping to commence bankruptcy cases in Delaware or the Southern District of New York).

[8] See, e.g., Press Release, Warren, Cornyn Introduce Bill to Prevent Large Corporations From "Forum-Shopping" in Bankruptcy Cases, September 23, 2021, https://www.warren.senate.gov/newsroom/press-releases/warren-cornyn-introduce-bill-to-prevent-large-corporations-from-forum-shopping-in-bankruptcy-cases.

[9] Press Release, Lofgren, Buck Reintroduce Bipartisan Legislation to End Corporate

served when corporate bankruptcies are adjudicated locally, with convenient court access for employees, retirees, and local creditors, as well as a judge who knows the affected community."[10]

The criticism presupposes that local court access best serves justice, but this article posits that employees, retirees, and creditors can often be better served by the precedent, procedures, and judges in locales other than those of their "home" court. In that regard, concerns over "gaming the system" might be misplaced – especially in an era of virtual hearings – if cases filed in experienced, sophisticated venues like the Southern District of New York can actually serve the interests of such constituents better than the stated intent behind the proposed legislative reform.

STATISTICAL ANALYSIS

As discussed below, reviewing statistical analysis as well as examining potential legal outcomes when assessing claims germane to the interest of "local" creditors supports the notion that location alone should not be a proxy for justice, and that to the extent reform is desired, more strategic, nuanced considerations should be explored.

First, a recent study analyzing bankruptcy claim trading pricing[11] suggested that forum shopping is not necessarily "tilted" against the economic interest of unsecured creditors, be they local trade vendors or employees and retirees, at least relative to senior secured creditors. Testing an efficient markets assumption that forum shopping is driven by a desire to access the experienced courts of New York and Delaware (along with their panels of sophisticated judges and robust caselaw and precedent to ensure a bankruptcy process that is more predictable) rather than driven by the "self-interested motivation" of corporate debtors, their professionals, and their senior creditors, the study sought to empirically assess and deduce forum shopping motivation by examining pricing information from a hand-collected dataset of 285 large bankrupt companies linked to the trading-price records of 1,049 financial contracts (investments characterized as corporate loans, bonds, and equity).[12]

Bankruptcy Forum Shopping, February 14, 2023, https://lofgren.house.gov/media/press-releases/lofgren-buck-reintroduce-bipartisan-legislation-end-corporate-bankruptcy-forum.

[10] Id.

[11] See Samir D. Parikh, Modern Forum Shopping in Bankruptcy, 46 Conn. L. Rev. 159, 193-96 (2013) (report finding that 80% of corporations utilized forum shopping to commence bankruptcy cases in Delaware or the Southern District of New York).

[12] Id.

The study found that debtors and their advisors desire access to predicable results obtained in the frequently "shopped" venues of the Southern District of New York and Delaware, and that such access matters. Specifically, the data did not support the often heard claim that senior claimholders drive forum shopping solely for their advantage.

Instead, the results generally supported a finding that the claims market was able to form more accurate recovery expectations from reorganization cases in Delaware and New York. Utilizing (i) ordinary least squares, and (ii) quantile regression analyses, the data demonstrated that Chapter 11 cases filed in New York or Delaware were associated with a lower pricing deviation when compared with other bankruptcy venues.

Moreover, the result was statistically significant after controlling for "firm size and industry, the lawyers advising the debtor, the duration of the bankruptcy case, changes in market conditions over the bankruptcy period, prepackaged or prenegotiated filings, and other potential confounding variables."[13] A key takeaway from the claims pricing study was that bankruptcy judges in the Southern District of New York and Delaware do not disproportionately approve plans of reorganization that transfer value to holders of senior claims from those of junior claims, suggesting that cases are not being filed in venues "far from home" with the stated intent, or at least result, to "tilt" the playing field against local and presumably junior creditor constituents.

Such a finding comports with a venue determination where a debtor and its advisors strategically decide to file in a venue not only where results are predictable, but where outcomes are perceived to be favorable for desired restructuring goals. For instance, the controlling precedent in many "home" venues – which would be the venue dictated under the proposed legislation – does not necessarily result in preferred outcomes for local creditors whose interests are ostensibly being promoted under the venue reforms. This can be assessed when examining the fortunes of one such local creditor constituency: employees.

A NEW YORK CASE

In New York for instance, *Straus-Duparquet, Inc. v. Local Union No. 3 Int'l Bhd. of Elec. Workers, A F of L, CIO*,[14] is often cited in support of the

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[13] Id.

[14] Straus-Duparquet, Inc. v. Local Union No. 3 Int'l Bhd. of Elec. Workers, A F of L, CIO, 386 F.2d 649, 651 (2d Cir. 1967) ("Since severance pay is compensation for termination of employment and since the employment of these claimants was terminated as an incident of the

proposition that claims for severance payments in connection with employment contracts rejected by a debtor under Bankruptcy Code Section 363 are entitled to administrative expense claim treatment, i.e., a 100% recovery.[15] This approach to employee severance claims is in the minority when compared to the applicable precedent that other local venues would have to follow where severance claims would most likely be treated as general unsecured claims similar to other claims for rejection damages.[16]

The reality is that in most "local" jurisdictions, the case law concerning severance claims will be more unfavorable for employees.[17] Thus, filing in a local venue would be unfavorable from the employee perspective relative to filing the case in the Southern District of New York. In that regard, filing in the local venue that the proposed the legislation would impose would actually limit the outcomes for employees.

Commentators have noted that limitation of venue choice could result in reductions in force when senior creditors see a Chapter 11 case as an opportunity to terminate workers, whereas the option for a company to commence in distant New York might stave off such efforts even if will increase the costs of the reorganization through incremental administrative claims.[18] At first blush, this type of outcome does not suggest a desire of companies to tilt results against local creditors.

EXISTING RECOURSE

If the concern is that venue shopping really is an abuse, recourse already exists. As a threshold matter, venue in the district where the debtor files is

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administration of the bankrupt's estate, severance pay was an expense of administration and is entitled to priority as such an expense.").

[15] Straus-Duparquet is still good law, but has been narrowed in regard to what is defined as "severance." Perhaps most clearly reasoned by the Second Circuit, "[i]n determining whether a payment incident to termination is entitled to priority as an administrative expense, the key inquiry is whether it represents a new benefit earned at termination or an acceleration of a benefit the employee earned over the course of his or her employment." In re Bethlehem Steel Corp., 479 F.3d 167 (2d Cir. 2007); see also In re Applied Theory Corp., 312 B.R. 225 (Bankr. S.D.N.Y. 2004), In re Majestic Cap., Ltd., 463 B.R. 289 (Bankr. S.D.N.Y. 2012).

[16] See, e.g., Roth American, Inc., 975 F.2d 949 (3d Cir. 1992) (deeming severance claims to be administrative claims only to the extent the services of the employee used to calculate the amount of the severance were rendered post-petition).

[17] See generally Braunstein v. McCabe, 571 F.3d 108 (1st Cir. 2009); In re Merry-Go-Round Enterprises, Inc., 400 F.3d 219 (4th Cir. 2005); In re Jones Truck Lines, Inc., 130 F.3d 323 (8th Cir. 1997); Peters v. Pikes Peak Musicians Ass'n., 462 F.3d 1265 (10th Cir. 2006).

[18] See, e.g., Andy Dietderich, Confessions of A Forum-Shopper: Part 1, XL No. 9 AM. BANKR . INST. J. 28, 52 (2021).

presumed to be proper.[19] A party can challenge venue, however, by establishing venue is improper by a preponderance of the evidence.[20] Thus, when Johnson & Johnson formed an affiliate to shoulder the potential liability from tens of thousands of talc-related cancer claims, it used the venue-selection rules to commence a Chapter 11 case in North Carolina, the court of its choice roughly 600 miles south of the company's New Jersey headquarters.[21] However, on November 16, 2021, in response to a motion to change venue, the bankruptcy court transferred the case to the District of New Jersey, ruling that the convenience of the parties and the interests of justice warranted the case being in the "home" venue of New Jersey because the debtor's operations were there; the debtor had no business in North Carolina other than a bank account; and 35,000 multi-district litigation cases were already pending in the District of New Jersey.[22] As such, when venue is truly problematic, bankruptcy courts already have the tools to move cases.

CONCLUSION

In attempting to address perceived venue abuses, Congress and proponents of reform may be inadvertently undercutting the very local creditor constituents that they purport to be protecting, especially when outcomes could vary in different venues. The reality is that there can be reasonable variations in the interpretation of ambiguous laws, and such variations are not necessarily unfair, illegitimate, or disruptive.[23] Therefore, allowing debtors to avail themselves of alternative venues under the current rules can provide certainty for some debtors while at the same time not necessarily be detrimental to local creditors and, in fact, might be beneficial in certain instances for local creditors. As such, companies and their local creditors may be better served with the current tools for reorganization, including venue, and they should continue to be made available, especially when recourse already exists to prevent blatant abuses.

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[19] See 28 U.S.C. § 1412; Bankr. R. 1014(a).

[20] See 28 U.S.C. § 1412; Bankr. R. 1014(a).

[21] Jonathan Randles, J&J Used Lenient Bankruptcy Rules to Push Talc Liabilities to Charlotte, The Wall Street Journal, Oct. 18, 2021, https://www.wsj.com/articles/j-j-used-lenient-bankruptcy-rules-to-push-talc-liabilities-to-charlotte-11634602947.

[22] See Order Transferring Case to the District of New Jersey, In re LTL Mgmt. LLC, No. 21-30589 (Bankr. W.D.N.C.), Doc. No. 416 (Nov. 16, 2021).

[23] See, e.g., Amanda Frost, Overvaluing Uniformity, 94 Va. L. Rev. 1567, 1639 (2008) (Noting, the federal system itself demands that citizens comply with the different laws of the different states, so it is unreasonable to claim that varied interpretations of federal law are automatically problematic).

Accordingly, when it comes to efforts to limit venue choice, location can be a hamstring as much as it can be a proxy for justice.

With this background, advisors to debtors should continue to advise their clients to avail themselves of all options presented by venue choices, and reformers should take into consideration that there may be a downside to venue restrictions.