Statement of

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H.R. 2533, “The Chapter 11 Bankruptcy Venue Reform Act of 2011”

September 8, 2011

House Subcommittee on Courts, Commercial and Administrative Law
Committee on the Judiciary
United States House of Representatives

Chairman Coble, Ranking Member Cohen, Chairman Smith, and Ranking Member Conyers, thank you for the opportunity to testify today. I am a law professor at the University of North Carolina at Chapel Hill. I am not engaged in the practice of law and have no financial stake in the fate of H.R. 2533. Earlier in my career, I was a staff attorney with the National Bankruptcy Review Commission, which endorsed a proposal to alter the venue laws for corporate bankruptcy cases, similar to H.R. 2533. I also am an elected member of the National Bankruptcy Conference and the American Law Institute. In this testimony, however, I speak entirely for myself as a teacher and scholar of bankruptcy and commercial law, and not on behalf of any individual or group.

Current venue laws give corporate bankruptcy filers exceptional latitude in selecting a forum. Of the more than two hundred large public companies that have filed for chapter 11 bankruptcy since 2005, nearly 70% have selected Wilmington, Delaware or New York City.[1] Some were actually headquartered in New York. But most were headquartered in cities like Charlotte, Detroit, Raleigh, Cleveland, Memphis, Nashville, Dallas, Houston, Phoenix, Riverside, Miami, Atlanta, Oklahoma City, Portland, and Seattle. Overall, the cases filed in Wilmington and New York City from 2005 to today were headquartered in more than thirty other states and the District of Columbia.

H.R. 2533 would increase the likelihood that companies headquartered around the country would file bankruptcy petitions at their headquarters. First, H.R. 2533 functionally eliminates a debtor's place of incorporation as a basis for venue. Second, H.R. 2533 addresses the affiliate venue rule. The current affiliate venue rule enables a company to follow an already-filed parent, subsidiary, or affiliated company into that first filer's venue even if that filer is miniscule relative to others in the corporate family. The proposed revision would permit subsidiaries to follow parents as a matter of right. It would require extra steps if multiple sister companies headquartered in different districts needed a coordinated restructuring.

This set of proposals was one of the few that received nearly unanimous support by the National Bankruptcy Review Commission, which was authorized by Congress in 1994 to examine the bankruptcy laws. In the past, such proposals have received the endorsement of lawmakers with a wide range of political and ideological views and state attorneys general.

Revising the options for corporate bankruptcy venue is fair, reasonable, and in line with principles of federal venue and aggregate litigation. Even if H.R. 2533 would not produce the perfect venue statute, it would enhance the appearance and reality of accessibility and fairness.

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Current bankruptcy venue laws are more permissive than other federal venue laws. Federal venue laws generally focus on the location of the persons involuntarily brought before the court. Thus, outside of bankruptcy, filers of civil actions are not permitted to choose a venue based solely on *their own* places of incorporation. 28 U.S.C. §§ 1391,1397. Bankruptcy venue rules, by contrast, focus on the entity commencing the case. 28 U.S.C. § 1408(1). A company can file a bankruptcy case in its own place of incorporation, however inconvenient that venue may be for the many creditors, equity holders, and communities affected by the bankruptcy.

In bankruptcy, a major corporation also can follow a small subsidiary into a district in which the rest of the company has no relationship. 28 U.S.C. § 1408(2). Enron took this path. This practice has no intentional analogue in other federal venue rules. Indeed, to the extent that a plaintiff claims that a parent "resides" in a district merely because its subsidiary is deemed to reside there for purposes of personal jurisdiction, the parent is likely to raise objections.

As an additional point of comparison, the case transfer rules diverge (although actual transfers in large cases are rare). Outside of bankruptcy, a civil action can be transferred for the convenience of parties and witnesses, in the interests of justice, only to a district or division "where it might have been brought," e.g., where there is proper venue. 28 U.S.C. § 1404(a). By contrast, on similar substantive showings, bankruptcy cases can be transferred to districts even if venue is not otherwise proper. 28 U.S.C. § 1412.

This flexibility for the filer, and potential inconvenience for other parties, is compounded by the fact that a corporate bankruptcy filer is relieved of establishing personal jurisdiction, in contrast with plaintiffs in civil actions. The rules establishing proper venue for a bankruptcy case are thus the main protection against strategic or inconvenient locations for creditors and other parties affected by the significant events that occur in a bankruptcy case. One could reasonably conclude that this justifies more restrictive venue rules for bankruptcy, not less.

Bankruptcy venue laws have enabled the concentration of a large proportion of cases in just two close-together East Coast districts. Supporters of the existing system ask us to take on faith that everyone affected by corporate bankruptcies are better off with this configuration. I am not aware of any systematic empirical evidence that supports this claim.

Furthermore, a considerable body of social science research suggests that outcomes should not be the exclusive metric for a public court system; parties have independent interests in participation and witnessing of the process that are not satisfied by virtual or large-group representation.[2] Perceptions of procedural fairness are critical.[3]

The stakeholders whose faith in the system might be shaken when bankruptcies are handled far from corporate headquarters are not the largest lenders, who exercise tremendous leverage over the bankruptcy through which they pursue their own interests.[4] Instead, one must also consider the stakeholders who, by their own standards, have much to lose and yet face many hurdles associated with an ongoing process in a far-away court: employees who have worked long hours for a salary and medical and retirement benefits that bankruptcy often dismantles; small suppliers of goods and services who may be greatly affected by whether the firm reorganizes or dissolves; government units that act as creditors, regulators, and protectors of the public interest; citizens deeply anxious over whether the debtor – perhaps the only nearby hospital – will keep its doors open; and the local press that will pursue the gritty details of the case's progress that national news outlets will likely ignore. As a majority of the United States Supreme Court observed long ago in a dispute over the doctrine of forum non conveniens, "[i]n 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." Gulf Oil Corp. v. Gilbert, 330 U.S. 501, 509 (1947). Although the bankruptcies of national or international corporations put pressure on this ideal, they do not render it irrelevant.

Although courts employ some technological innovations, technology can do only so much to address the perception or reality of inaccessibility. Video conferences can be costly and complicated, and, given the variety of equipment used, telephonic appearances can be awkward, with parties speaking over each other and straining to be heard. Moreover, even if a judge is willing to take evidence telephonically, it is difficult for that judge to meaningfully assess a witness's credibility over the telephone, as compared to the witnesses present in the courtroom. Likewise, giving telephone access to the press and other news media may reduce the quality of the reporting of the events in public courts, assuming the court is willing to allow non-parties to "listen in" to the proceedings by telephone. All of this implicitly tilts the playing field in favor of the debtor, the major lenders, and other parties and professionals who are easily able to be physically present.

Supporters of the existing system sometimes contend that the non-incorporation tests for venue (principal place of business and principal assets) are no more convenient for stakeholders than a venue that results from some combination of place of incorporation and affiliate location (e.g., New York or Delaware). The Delaware State Bar Association raised a similar critique of principal place of business in 1996 when the National Bankruptcy Review Commission considered a similar proposal. The Commission studied the dataset that the Delaware State Bar Association offered. As the Commission's final report explains, in nearly all cases smaller creditors would have had better access in the principal place of business than in the place of incorporation.[5] And based on a database of public submissions to the Commission (that continues to be available on the American Bankruptcy Institute website),[6] the final report notes that "[d]isenfranchisement 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."[7]

This being said, no one can promise that use of a principal place of business or assets standard will enable every stakeholder to take public transit to the courthouse when large companies file for bankruptcy. But critiquing principal place of business or assets hardly helps to justify place of incorporation or a boundless affiliate venue rule, neither of which considers stakeholder access at all. Instead, such critiques suggest that an entirely different case-placing system should be considered to replace the status quo.

It is helpful to recall the observations of the late Lawrence P. King. Professor King was the Charles Seligson Professor of Law at New York University, of counsel at a prominent New York law firm, and editor-in-chief of the leading bankruptcy treatise. At an early public meeting of the National Bankruptcy Review Commission, Professor King opined on his own behalf that state of incorporation offered no meaningful connection to a district for bankruptcy purposes.[8] Indeed, in the context of civil actions outside of bankruptcy, it is not unheard of for corporate defendants to complain of the inconvenience of litigating in their place of incorporation, and their lack of connections to the forum, as compared to their corporate headquarters.[9] When the Judicial Panel on Multidistrict Litigation sends a consolidated set of civil actions to a particular district and judge for pretrial purposes, place of incorporation does not seem to be a substantive factor weighing into the decision.[10]

Perhaps the best one can say about place of incorporation is that it is an objective fact. But we could say the same about a system that permitted debtors to choose from all districts or from a random sample of districts, or that permitted debtors to pre-commit to bankruptcy venue well before the onset of financial distress.

Defenders of the current system ask us to leave the system as it is, and keep the burden on far-away stakeholders to request a transfer of cases. Everyone can point to some examples of actual transfers. But they rarely occur in the largest voluntary cases. The reasons were laid out quite clearly two decades ago by Professors William C. Whitford and Lynn M. LoPucki in the Wisconsin Law Review, and reemphasized by Professors Theodore Eisenberg and LoPucki about a decade ago in the Cornell Law Review. Smaller creditors lack the necessary information to effectively challenge venue until the case is firmly entrenched in the initial district. Unless major financial institutions or the creditors' committee join the motion to transfer venue (both of which are unlikely), the price and burden of proof is high and the chance of success is low. Again, we can learn from Professor King, who opined at a public meeting on his own behalf that the theoretical possibility of transfer was not getting big cases where they should be, and a statutory fix to narrow the venue options was necessary.[11]

Elimination of place of incorporation for corporate bankruptcy venue is reasonable and will increase the perception as well as the reality of accessibility and fairness in many instances. H.R. 2533 makes this change in a way that leaves existing 28 U.S.C. § 1408 intact for all debtors other than those subject to the new venue rule. As indicated by the word "only" in the preamble to section 1408(b), the more restrictive venue test is mandatory for corporations (and limited liability corporations and limited liability partnerships) in chapter 11 and the time period for measuring the other venue metrics has been enlarged to one year. Other debtors will still be able to file where they reside or are domiciled.

As for the affiliate venue rule, the reformed version in H.R. 2533 permits integrated corporate families to follow a parent into a district. If the parent does not file, then related chapter 11 debtors could prepare a motion with their proposed first-day orders to request judicial consideration of the best district for the cases to be jointly administered. This process is already authorized by the Federal Rules of Bankruptcy Procedure. FED. R. CIV. P. 1014(b); 28 U.S.C. §

1412. And given that judicial economy is valued in venue choices, courts are unlikely to refuse. A debtor's own motion does not face the same burdens as a far-away stakeholder's motion. The difference between a debtor asking for a venue change to join an affiliate, and a far-away stakeholder asking to move the case against the debtor's will, are like day and night.

This being said, the transfer process is hardly cost-free, especially if filings must first be made across multiple districts, and if the debtor must prepare for the possibility of a consolidated filing in one of several districts. Again, the early work of Professors Whitford and LoPucki is instructive in their observation that bankruptcy formally deals with entities, but restructurings need to account for enterprises. The disconnect meant that a restrictive affiliate venue rule could block some corporate groups from filing together when they should do so, while other affiliates could file together even if they lacked a common enterprise and this choice inconvenienced creditors. Professor King similarly noted the utility of restructuring enterprises in one district.[12]

H.R. 2533's affiliate venue test is also vulnerable to the critique that it permits operating subsidiaries to follow a holding company into the latter's venue that could be inconvenient for other parties. This too is a legitimate concern, and H.R. 2533's longer look-back period to determine principal place of business or assets goes only part of the way to address this problem. In the 1990s, members of the ABA Business Law Section's Business Bankruptcy Committee recommended that coordinated affiliate filings be permitted on the basis of a dominant operating affiliate's principal place of business or assets rather than on the basis of a holding company parent's filing.[13] That objective remains a good one assuming that language can be found to achieve that goal without creating other problems.

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Proponents of the current system suggest that judges in other districts are ill-equipped to handle the largest cases. This assumption should not go unquestioned. Bankruptcy judges go through a rigorous process of merit selection by the United States Court of Appeals for each circuit. As a result, the process is less politicized than Article III judicial appointment. If opponents of venue reform believe that something different and better is happening in the selection process in the Second and Third Circuits – or, more precisely, for the courts only in

New York City and Wilmington, Delaware – they should say so explicitly so that other circuits can evaluate those practices.

Lawyers who defend the current system often note that they want judges with a lot of experience to handle the biggest bankruptcies. This type of argument is used in many contexts and can become a self-fulfilling prophecy. Of course, the District of Delaware became popular precisely because lawyers liked how a judge handled her very first large cases.[14] Had the first big case not been filed there, lawyers would never have known her capabilities. Although the Judicial Panel on Multidistrict Litigation also values experience, it spreads MDLs across the country; currently, over two hundred judges preside over one or more.[15] Overall, though, it is hard to sustain the claim that a judge needs to have previously overseen a case in order to be assigned a case. By definition, no one joins the bankruptcy bench having already presided over a large and complex bankruptcy case, or any bankruptcy case. The same can be said for all kinds of federal actions that go to the U.S. District Court, including matters literally of life and death.

Also, while a high proportion of big cases has gone to two magnet cities, judges elsewhere have effectively handled other extremely large and complicated cases, as well as the vast majority of business bankruptcy cases filed in this country. The biggest cases may require more speed and different procedures, but the underlying principles and doctrines are the same regardless of the size.

Supporters of the current system also appreciate the protocols, norms, and local rules of New York City and Wilmington that aid accessibility and quick action in the largest cases. Nothing prevents other districts from adopting those tools.[16] The Southern District of Texas, the Northern District of Texas, the District of Massachusetts, the District of New Jersey, the Western District of Pennsylvania and others already have developed complex case designations and associated procedures. Judges also may be willing to consider special procedures that parties propose for larger cases. Of course, there may be more the court system as a whole could do to sensitize judges to special needs of larger cases, but none of this justifies preserving the current system.

Commentary on bankruptcy judging also produces an inconsistent picture of the role judges play. Lawyers have argued emphatically that judges are not responsible when companies need to file a second chapter 11 case. If courts are to be held blameless when restructurings fail, it hardly stands to reason that good outcomes (assuming there's evidence) automatically justify the status quo. Lawyers also have at times pointed to case burdens in the magnet courts to explain judges' limited opportunity to scrutinize all the details of chapter 11 plans. H.R. 2533 would ease case load burdens for those courts and contribute to more robust development of substantive bankruptcy law and innovation in large case management.

Finally, even if the judiciary itself were to conclude that only a subset of judges should handle major restructurings, such a conclusion would not justify the current venue system. For a more structural response, Congress could implement a provision like that used in chapter 9 municipality cases, under which the chief judge of the applicable court of appeals appoints the bankruptcy judge to oversee the case. 11 U.S.C. § 921(b). Or, following the model of the Judicial Panel on Multidistrict Litigation, Congress could establish a panel of Article III judges that decides where and to whom to assign the largest bankruptcy cases. 28 U.S.C. § 1407. Given that Congress has declined to take these actions so far, the strong assumption in the current structure of our bankruptcy system is that those appointed to the bench are equipped to handle the full array of commercial and consumer bankruptcy cases. I close by mentioning these other ideas to illustrate that some supporters of the status quo give us a false choice between well-overseen cases and a fairer bankruptcy system.

Thank you again for the opportunity to participate in this hearing.

End Notes

[1] The characterization of a case as a "large public company" and the associated data come from the UCLA-LoPucki Bankruptcy Research Database. The term applies to filings of companies with over $100 million in assets in 1980 dollars. My searches are further limited to voluntary chapter 11 filings.

[2] *See, e.g.*, Judith Resnik, Dennis E. Curtis, & Deborah R. Hensler, *Individuals within the Aggregate: Relationships, Representation, and Fees*, 71 N.Y.U. L. REV. 296, 306, 361, 364, 372 (1996).

[3] *See, e.g*., Tom R. Tyler, *What is Procedural Justice?: Criteria Used by Citizens to Assess the Fairness of Legal Procedures*, 22 LAW & SOC'Y REV. 103 (1988).

[4] *See* Jay Lawrence Westbrook, *The Control of Wealth in Bankruptcy*, 82 TEX. L. REV. 795 (2004) (explaining why secured lenders' interests diverge from other creditors); Kenneth M. Ayotte & Edward R. Morrison, *Creditor Control and Conflict in Chapter 11*, 1 J. LEGAL ANALYSIS 511, 513 (2009) (documenting considerable control over bankruptcy process by senior secured lenders, and finding over-secured creditors prefer immediate resolutions, such as quick sales, that will satisfy their own claims even if reorganization is possible").

[5] NATIONAL BANKRUPTCY REVIEW COMMISSION FINAL REPORT 785-86, 791 (1997).

[6] http://www.abiworld.org/AM/Template.cfm?Section=Submission_Abstract&Template=/CM/ContentDisplay.cfm&ContentID=36677

[7] NATIONAL BANKRUPTCY REVIEW COMMISSION FINAL REPORT 886 (1997). *See also* GORDON BERMANT ET AL., CHAPTER 11 VENUE CHOICE BY LARGE PUBLIC COMPANIES, REPORT TO THE JUDICIAL CONFERENCE ON THE ADMINISTRATION OF THE BANKRUPTCY SYSTEM 5 (FED. JUD. CENTER 1997).

[8] Minutes of the National Bankruptcy Review Commission, February 23, 1996, Washington, D.C.

[9] For some recent examples, see, e.g., Everglades Interactive, LLC v. Playdom, Inc., Civ. No. 10-902-SLR, 2011 WL 2294075 (D Del. June 8, 2011) (motion denied); Marvell Int'l v. Link_A_Media Devices Corp., 10-869-SLR, 2011 WL 2293999 (D. Del. June 8, 2011) (motion denied); Gielata v. Heckmann, 10-378-LPS-MPT, 2010 WL 3940815 (D. Del. Oct. 6, 2010) (motion denied); Illumina, Inc. v. Complete Genomics, Inc., 10-649, 2010 WL 4818083 (D. Del. Nov. 9, 2010) (motion granted); Human Genome Sciences, Inc. v. Genentech, Inc., 11-082-LPS, 2011 WL 2911797 (D. Del. July 18, 2011) (motion granted); Synthes USA, LLC v. Spinal Kinetics, Inc. 08-838-SLR, 2009 WL 463977 (D. Del. Feb. 24, 2009) (motion granted).

[10] *See, e.g*., John G. Heyburn II, *A View from the Panel: Part of the Solution*, 82 TUL. L. REV. 2225 (2008) (written by the Chair of the JPML); Daniel A. Richards, *An Analysis of the Judicial Panel on Multidistrict Litigation's Selection of Transferee District and Judge*, 78 FORDHAM L. REV. 311 (2009) (sample of transfer orders); DAVID F. HERR, MULTIDISTRICT LITIGATION MANUAL Ch. 6 (2011).

[11] Minutes of the National Bankruptcy Review Commission, February 23, 1996, Washington, D.C.

[12] Minutes of the National Bankruptcy Review Commission, February 23, 1996, Washington, D.C.

[13] G. Eric Brunstad, Jr., Mike Sigal, & William J. Schorling, *Review of the Proposals of the National Bankruptcy Review Commission: Part I*, 53 BUS. LAW. 1381, 1435 (1998) (reporting on initiative of Business Bankruptcy Committee).

[14] Harvey R. Miller, *Chapter 11 Reorganization Cases and the Delaware Myth*, 55 VAND. L. REV. 1987, 1990 & fn. 8, 1991 (2002).

[15] UNITED STATES JUDICIAL PANEL ON MULTIDISTRICT LITIGATION, MDL STATISTICS REPORT - DISTRIBUTION OF PENDING MDL DOCKETS, JULY 14, 2011.

[16] Subcommittee on Venue-Related Matters of the Judicial Conference Committee on the Administration of the Bankruptcy System & the Federal Judicial Center, Conference on Large Chapter 11 Cases, Jan. 30-Feb. 1, 2003, at 39-40.