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THE BANKRUPTCY VENUE LAWS MAY BE CHANGING

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There are 94 federal judicial districts in the United States, yet the largest bankruptcy cases tend to be filed in just two: the Southern District of New York and the District of Delaware. A bill pending in Congress would significantly limit corporations' access to these courts: the "Chapter 11 Bankruptcy Venue Reform Act of 2011," H.R. 2533 ("BVRA"), which was introduced in July 2011 and is sponsored by Lamar Smith (R-TX), John Conyers (D-MI), Howard Coble (R-NC) and Steve Cohen (D-TN).

"Bankruptcy venue" has become a hot-button issue, as high-profile companies have filed far from their principal place of business. For example, in 2009, Michigan's attorney general wrote letters to the CEOs of General Motors and Chrysler urging that if they filed bankruptcy, they do so in Michigan, because of Michigan's interest in those companies and the risk of unfairness to creditors. Similar concerns were raised when Enron filed in New York instead of Texas, and when Polaroid filed in Delaware rather than Massachusetts.

The debate over bankruptcy venue is intellectually principled up to a point -- including discussions about what venue rule promotes successful reorganizations, and serves the objectives of equality among creditors and maximizing recoveries. However, there is a healthy dose of self-interest involved, on both sides. Bankruptcy is big business. Large cases keep lawyers and other local professionals busy, fill hotel rooms, restaurants and taxis, and generate tax revenues. Delaware and New York would like to keep what they have, while the rest of the country wants a piece of the pie.

BVRA's proposed changes

Under current law, a corporation can file bankruptcy in its state of incorporation, the location of its principal place of business or principal assets, or where an affiliate of the corporation has a pending bankruptcy case.

BVRA would make two fundamental changes. First, it would remove state of incorporation as a basis for bankruptcy venue. Second, BVRA would limit the affiliate venue rule to cases where a *parent* owning 50% or more of the debtor has filed bankruptcy.

To illustrate, assume that a group of affiliated corporations with 300 employees and $250 million in annual revenue is considering bankruptcy. The parent corporation, Kan-Co, is

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incorporated in Delaware but has its headquarters and substantially all of its assets in Kansas. Kan-Co has four subsidiaries that are also Delaware corporations with their assets, offices and headquarters in Kansas. Kan-Co has a fifth subsidiary, NY-Co. NY-Co is incorporated in New York and its headquarters and assets are located in New York. NY-Co employs 6 of the 300 employees and accounts for $2 million of the $250 million in annual revenues.

Under current law, Kan-Co could file in Delaware, its state of incorporation. Or, it could file in New York by first having its affiliate, NY-Co, file bankruptcy in New York, with Kan-Co filing immediately thereafter under the "affiliate venue" provision. Finally, Kan-Co could file in Kansas, the location of its headquarters and principal assets.

Under BVRA, Kan-Co could file only in Kansas. It could not file in Delaware because BVRA removes state of incorporation as a basis for venue. And it could not file in New York because BVRA limits a company's choice of venue based on an affiliate's case to an affiliate that is a parent, and here NY-Co is a subsidiary.

Arguments for maintaining the current venue statute

Those who oppose BVRA tend to articulate a "race-to-the-top" theory. They contend that a corporation should be able to select a venue that gives it the best chance for an efficient and successful reorganization. Many times, they say -- particularly in large and complex cases -- that means New York or Delaware. While there are very capable judges throughout the country, New York and Delaware judges have substantial experience with "mega" cases and complex financial structures. Those courts have local rules and procedures aimed at streamlining complex reorganizations and they have developed well-known precedent on many issues that arise in chapter 11 cases, which enhances predictability. This includes "market provisions" for financing and cash collateral orders, asset sales and certain plan provisions. BVRA's opponents point out that the Delaware and New York bankruptcy courts have faced most issues many times previously, and thus rarely need to re-invent the wheel. New York and Delaware also offer proximity to a large number of experienced restructuring professionals. Finally, BVRA's opponents contend that eliminating state of incorporation as a basis for venue would be inconsistent with the historical practice of allowing states, rather than Congress, to oversee corporations.

Arguments in support of BVRA

In contrast, proponents of BVRA may view the current bankruptcy venue provisions as encouraging a "race-to-the-bottom." They say competition for the biggest cases has lead New York and Delaware courts to adopt rules and procedures that are too friendly to debtors and their professionals. They point out that a debtor's professionals often guide the venue decision, and allege that the professionals tend to select venues that will allow high fees. They contend that Delaware and New York bankruptcy courts have not been sufficiently rigorous in evaluating plan feasibility, resulting in more failed reorganizations and chapter 22 situations. They emphasize the local interests in a bankruptcy case. Not all creditors are national banks, hedge funds, etc. Local trade creditors, local taxing authorities, landlords, and employees may find it especially difficult to participate when a chapter 11 case is filed hundreds or thousands of miles

away. And, relatively speaking, the impact of a bankruptcy on a small business or employee might be greater than the impact on a national bank. Supporters of BVRA say these local interests are better served when local creditors have ready access to the court and the case is supervised by a judge who lives and works in the community.

Looking ahead

Whether BVRA will advance in Congress remains uncertain. Other attempts to amend the venue statute have failed, most recently in 2005, in part due to the opposition of Joe Biden, then a Senator from Delaware. BVRA was the subject of a House subcommittee hearing on September 8, 2011, and seemed to have the support of the Representatives in attendance, some of whom are sponsors of the bill. On the other hand, a Representative from Delaware (who was not a member of the subcommittee) attended the hearing to express his opposition. Other opposition is likely to emerge if the bill advances. For now, businesses and restructuring professionals will want to watch BVRA -- its changes may appear technical at first glance, but they would have a substantial impact on corporate bankruptcy cases.