Proposed Chapter 11 Venue Legislation Introduced

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A significant consideration in a prospective chapter 11 debtor's strategic prebankruptcy planning is the most favorable venue for the bankruptcy filing. Given varying interpretations among different bankruptcy courts of certain important legal issues (*e.g.*, a debtor's ability to pay the claims of "critical" vendors at the inception of a chapter 11 case, to include nondebtor releases in a chapter 11 plan, or to reject collective bargaining agreements) and the reputation, deserved or otherwise, of certain courts or judges as more "debtor-friendly" than others, choice of venue (if a choice exists) can have a marked impact on the progress and outcome of a chapter 11 case.

The Southern District of New York and the District of Delaware have long been the preferred forums for large chapter 11 cases. Given New York's recognized status as the financial capital of the U.S. (and arguably the world), the fact that its bankruptcy courts regularly preside over a significantly greater proportion of complex chapter 11 restructurings than courts located elsewhere is not surprising. Delaware's courts have similarly developed considerable experience, expertise, and filing procedures in complex chapter 11 cases, but the district's prominence as a frequent venue for chapter 11 "mega-cases" also is based in part on the statutory venue requirements that apply to bankruptcy filings.

The rules that determine which particular venue(s) is (are) appropriate for a bankruptcy filing permit a debtor to file for bankruptcy protection in the bankruptcy court located in the debtor's state of incorporation, which for a significant percentage of corporations is Delaware. Specifically, 28 U.S.C. § 1408 provides that a debtor may commence a bankruptcy case in a district where: (i) the debtor is domiciled, resides, has a principal place of business, or has

principal assets, generally within 180 days immediately preceding the commencement of the case; or (ii) there is another bankruptcy case pending with respect to an affiliate, general partner, or partnership of the debtor.

Because a large number of companies do not conduct business or own assets in the state in which they are incorporated, the state of incorporation as a basis for venue has been criticized by some members of Congress (while being defended by others) as providing a pretext for "forum shopping," which permits a chapter 11 debtor to sort out its financial problems far removed from creditors and other parties with a stake in the outcome of the case.

On July 14, 2011, the chairman of the House Judiciary Committee, Lamar Smith (R-Texas), and ranking member John Conyers, Jr. (D-Michigan), introduced the Chapter 11 Bankruptcy Venue Reform Act of 2011 (H.R. 2533) to prevent what they deem to be forum shopping in chapter 11 cases. The proposed legislation would modify 28 U.S.C. § 1408 by limiting venue to: (i) the location of the debtor's principal place of business or principal assets in the U.S. during the year immediately preceding the commencement of the chapter 11 case (or the portion of such one-year period exceeding that of any other district in which the debtor had such place of business or assets); or (ii) the district in which an affiliate of the debtor that owns, controls, or holds with power to vote more than 50 percent of the outstanding voting securities of such debtor has its chapter 11 case pending. If it were to become law, this proposed legislation would in many cases prevent a debtor from commencing a chapter 11 case in its state of incorporation or from "piggybacking" on the filing of a subsidiary.

As reflected by the press release issued by the House Committee on the Judiciary, the rationale underlying the proposed legislation appears to be its sponsors' frustration that certain mega-cases have been filed in the Southern District of New York, a venue they perceive to be "management-friendly," although most creditors and employees of the debtors in question were located elsewhere. According to the bill's sponsors, permitting corporations to file for chapter 11 far from home leaves employees, creditors, and other stakeholders "without a voice in the negotiations." They contend that the proposed legislation would level the playing field between employees and management.

Some restructuring professionals have criticized the proposed legislation. The Committee on Bankruptcy and Corporate Reorganization of the Association of the Bar of the City of New York condemned the legislation as unnecessary and premised on the unsubstantiated view that the current venue rules are flawed, lead to abuse and improper forum shopping, and compromise the independence of bankruptcy judges. According to the Committee, among other things, even if the current venue rules do in fact permit improper forum shopping, courts already have a mechanism—28 U.S.C. § 1412—to transfer venue to another jurisdiction if they determine that the venue was initially selected improperly or that the existing forum is inconvenient for the stakeholders involved.

On August 25, 2011, H.R. 2533 was referred to the House Subcommittee on Courts, Commercial and Administrative Law. Initial hearings were conducted before the Subcommittee on September 8.