GEORGETOWN UNIVERSITY LAW CENTER

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Hon. Lamar Smith
Chairman
House Committee on the Judiciary
2138 Rayburn House Office Building
Washington, DC 20515

Re: H.R. 2533, the "Chapter 11 Bankruptcy Venue Reform Act of 2011"

Dear Mr. Smith:

I am a Professor of Law at the Georgetown University Law Center, where I teach courses in bankruptcy and commercial law. I have also previously served as the Scholar in Residence at the American Bankruptcy Institute. I write in support of H.R. 2533, the "Chapter 11 Bankruptcy Venue Reform Act of 2011." I urge the House Judiciary Committee to support this bill which reforms Chapter 11 bankruptcy venue so as to prevent forum shopping by debtors.

I. The Los Angeles Dodgers of Delaware and Other Bankruptcy Venue Oddities

The current bankruptcy venue statute permits business entity debtors to file in the district in which they are headquartered, in the district in which their principal assets are located, in any district in the state in which they are incorporated, or in any district in which one of their affiliates has filed.[1] This system gives debtors tremendous leeway in choosing where to file their bankruptcies. The result has been the proliferation of bankruptcy filings in venues with at best a nominal connection to the debtor. For example, the Los Angeles Dodgers filed for bankruptcy in the District of Delaware, where they have an incorporated entity, but no assets or operations or even substantial creditors.

[1] 28 U.S.C. § 4801 (providing for venue for cases filed under Title 11 "in the district court for the district in which the domicile, residence, principal place of business in the United States, or principal assets in the United States" of the debtor are located or "in which there is pending a case under title 11 concerning such [debtor]'s affiliate, general partner, or partnership.").

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Moreover, with minimal planning, a debtor can easily game the venue system. The most common method for doing this is "bootstrapping." This is done by having the debtor-to-be create a subsidiary in the desired filing district and then having the subsidiary file for bankruptcy in that district. This allows the rest of the corporate family to be "bootstraped" into that district under the venue statute's provision permitting venue in a district where an affiliate of the debtor has filed for bankruptcy. The result is that the debtor can file in a district in which it has neither substantial assets nor operations nor incorporation and maybe not even creditors.

The bootstrapping phenomenon has been on display in major bankruptcy cases since at least the early 1980s, when Eastern Airlines, a Texas-based airline, bootstrapped its bankruptcy filing into the Southern District of New York by having its affiliate Ionosphere Club file first in the Southern District of New York. This practice has been repeated in many major bankruptcies. Thus, Enron, which filed in the Southern District of New York despite having only minimal assets and operations in that state, and General Motors used a wholly-owned dealership, Chevrolet-Saturn of Harlem, that was based in New York, to bootstrap in the rest of its corporate family into the Southern District of New York bankruptcy court.

Bootstrapping enables forum shopping, but whatever one thinks of bootstrapping, it is permitted by the terms of the venue statute. The abuse of venue has become so routine that Borders bookstores dispensed with all pretenses of compliance with the venue statute in its bankruptcy filing in the Southern District of New York. Borders involved a filing by eight corporate entities, none of which were New York entities. The filing group included Colorado, Delaware, Michigan, and Virginia entities, making venue proper in districts in any of those states. Borders' sole connection with the Southern District of New York was that a few of its 632 stores were located in Manhattan.[2] This flimsy connection to the Southern District of New York was patently insufficient to comply with the bankruptcy venue statute. Indeed, the violation was so blatant, that it was spotted by one of my law students, an LLM student from India. Neither the court[3] nor the U.S. Trustee, however, made any objection to the venue.[4]

As far as I can tell, the same situation occurred in Chrysler's bankruptcy filing in the Southern District of New York. The initial filing entity was Chrysler Realty Co., LLC, a Delaware limited liability company headquartered in Michigan. The Chrysler bankruptcy petition indicated that venue was proper based on the debtor having been domiciled or having "had a residence, principal place of business, or principal assets in this District for 180 days immediately preceding the date of this petition or for a longer part of such 180 days than in

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[2] Adam J. Levitin, *Borders Improper Bankruptcy Venue,* Creditslips.org, Feb. 28, 2011, *at* http://www.creditslips.org/creditslips/2011/02/borders-improper-bankruptcy-venue.html.

[3] Bankruptcy Rule 1014 provides that "If a petition is filed in an improper district, the court, on the timely motion of a party in interest or on its own motion...may dismiss the case or transfer it to any other district if the court determines that transfer is in the interest of justice or for the convenience of the parties."

[4] The lack of objection from the US Trustee is particularly troublesome given that the U.S. Trustee will readily object to improper venue in consumer bankruptcies even when the courthouse in the district in which the debtor has filed is much more convenient for the debtor than the courthouse in the proper district. Knowingly or negligently signing off on a materially false declaration of proper venue raises serious ethics issues for bankruptcy attorneys.

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any other District."[5] The petition itself contained no further clarification of the basis for venue. Given that Chrysler Realty Co., LLC is a Delaware entity headquartered in Michigan, the only possible basis for venue would be the location of the company's principal assets. The petition, however, contained no averment whatsoever about the location of those assets.[6]

Chrysler Realty Co., LLC filed its schedule of assets with the court almost four months later.[7] This schedule indicates that Chrysler Realty Co., LLC owned two properties, with combined scheduled values of $15 million and $9.6 million, that were located in the Southern District of New York. Located at these properties are Manhattan Jeep Chrysler Dodge and Yonkers Avenue Dodge. They represent only 2.8% of Chrysler Realty Co., LLC's scheduled assets of $875 million and 2.2% of Chrysler Realty Co., LLC 87 scheduled real properties. It is hard to believe that these two dealership buildings constitute the "principal assets of the debtor" either in terms of importance or in terms of dollar amount or numerosity. It would appear, then, that Chrysler's bankruptcy should not have been conducted in the Southern District of New York.[8]

II. The Harms of Bankruptcy Forum Shopping

The central problem with the venue statute as it stands is that it enables forum shopping. Forum shopping enables debtors to pick what law they want—to the detriment or benefit of particular creditor constituencies. For example, a debtor that is hoping to reject a collective bargaining agreement will avoid filing in the Third Circuit because of the *Wheeling-Pittsburgh Steel* precedent that limits the rejection of collective bargaining agreements to "necessary modifications" for ensuring the debtor's short-term survival and avoidance of liquidation. Debtors seeking to assume intellectual property licenses will avoid the Ninth Circuit because of the *Catapault* precedent in that Circuit that favor licensors. Debtors seeking to use cross-collateralization to obtain debtor-in-possession financing will avoid the Eleventh Circuit's *Saybrook* precedent. The ability to forum shop enables debtors (sometimes in coordination with particular creditors, especially their debtor-in-possession lenders) to pick the most favorable venues in terms of law. There is a danger that this could produce a "race to the bottom" in bankruptcy law, if districts compete for filings through increasingly debtor-friendly rulings.

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[5] Petition, *In re Chrysler Realty Co., LLC*, 09-50000-ajg, Bankr. S.D.N.Y., Apr. 30, 2009 (Docket No. 1).

[6] It is worth remembering that Chrysler has never owned the Chrysler building; it was originally owned by William Chrysler himself and has since changed hands many times, but even when it served as Chrysler's headquarters, it was not company property.

[7] *In re Old Carco LLC (f/k/a Chrysler LLC*), et al., Global Notes and Statement of Limitations, Methodology, and Disclaimers Regarding Debtors' Schedules of Assets and Liabilities and Statements of Financial Affairs, *In re Chrysler Realty Co., LLC*, 09-50000-ajg, Bankr. S.D.N.Y., Aug, 12, 2009 (Docket No. 5084). While the notes are global and apply to all 26 Chrysler entities that filed for bankruptcy, the schedules appear to be solely for Chrysler Realty Co., LLC.

[8] If so, then it would also appear that Chrysler's bankruptcy petition contained a materially false statement to the court. It is important to note that this does not mean that Chrysler's bankruptcy would have been conducted in the Eastern District of Michigan. Chrysler could easily have filed for bankruptcy in Delaware and had proper venue under the current statute, despite having no scheduled assets located in that district.

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Forum shopping can also affect outcomes in more subtle ways. For example, appointment of a trustee is largely a discretionary matter with the bankruptcy court as it is under a "for cause" standard.[9] Forum shopping also enables debtors to select filing districts in which judges are unlikely to appoint trustees and to allow the debtor's management to remain in place as debtor in possession; this was reportedly a critical factor in Enron's decision to file in the Southern District of New York. (Doing so also preserved the firm's attorney-client privilege, which might have affected federal and state investigations of Enron officers and directors).

Forum shopping may also be done on the basis of courts' willingness to approve the fees of attorneys and financial advisors. Bankruptcy courts must approve the fees of the attorneys and other professionals for the debtor and official committees. Courts' willingness to approve fees varies in part based on the going local market rate; a bankruptcy court in the Southern District of New York does not blink at an attorney billing $900, but a court in the District of Montana might. There are relatively few law firms with sufficient personnel to handle large bankruptcy cases, and most are based in New York. The result is that debtors' attorneys (of whom I was once one) are a constituency with an interest in steering filings to districts where judges will not question their billing rates.[10] Hiring billing rates mean that more of the bankruptcy estate's assets are diverted to pay attorneys and other professionals, with less left for unsecured creditors and equityholders. Thus, forum shopping can directly hurt creditors' bottom line by increasing the transaction costs of bankruptcies.

Forum shopping also harms local creditors, such as employees and small businesses, as it frequently results in filings in inconvenient, distant districts. These smaller local creditors cannot afford to monitor distant cases, much less make appearances, and are thus unable to exercise their rights as creditors through participation in the bankruptcy. Similarly, having a bankruptcy taking place far from a firm's base of operations means that employees—whose livelihoods and retirement benefits may be on the line—are unable to exercise their right to make their presence felt through demonstrations near the courthouse.

III. Problems with the Expertise Argument

The major argument made in favor of the current venue statute is that it allows debtors to file in districts that have developed expertise in handling large business bankruptcies, particularly the Southern District of New York and the District of Delaware. While it is true that these districts have developed an expertise and have many outstanding bankruptcy judges, the expertise argument cannot support the current venue system both because expertise is neither limited to nor guaranteed in SDNY and Delaware and because expertise is an argument for a *single* specialized court, not a menu of courts.

It is frankly hard to accept assertions that the SDNY and Delaware bankruptcy judges have unusual expertise or skill that is lacking in other districts. We have seen major cases

[9] 11 U.S.C. §1104.

[10] Similarly, attorneys based in SDNY and Delaware may simply wish to avoid the inconvenience of having to handle cases in other districts where they will have to do more travelling. As courts are increasingly comfortable with telephonic and video hearings, travel is less necessary and there is less expense for bankruptcy estates.

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successfully handled by many other districts, including the Northern District of Illinois, the Eastern District of Michigan, the Western District of Missouri, and the Northern District of Texas. These courts have all shown themselves more than capable of handling large, complex bankruptcies.

Similarly, expertise and skill varies among judges in the SDNY and Delaware, just as it does among judges in other districts. There is no guarantee that a new bankruptcy judge in any district will handle a case as well as in other districts. Indeed, it is worth recalling that SDNY and Delaware didn't always have their current level of expertise.

There is also no evidence that SDNY or Delaware venue produces superior results. A major study by Professor Lynn LoPucki at the UCLA Law School argues that in fact there are higher failure rates of Delaware and SDNY reorganizations.[11]

Even assuming that there was demonstrably greater expertise in SDNY and Delaware than elsewhere in the country, the expertise argument does not support the current venue system. Instead, expertise is an argument for funneling all filings to a single district. It does not support permitting debtors to pick their own venue even as between the Southern District of New York and the District of Delaware. If one is to take the expertise argument seriously, it points to requiring a single venue for all large business bankruptcy cases.[12]

IV. Lack of Objection Does Not Mean Consent to Venue

It is important to address a spurious argument made by defenders of the current venue system, namely that if venue were being abused, creditors would readily object to it. First, the creditors may simply be unaware with there being a venue problem. They are entitled to rely upon the assertions made—under penalty of law—in bankruptcy filings, and to assume that the U.S. Trustee's office will police venue. They may also assume that if there is a problem some other creditor would have objected. But even if a creditor identifies a venue problem, it hardly means that there will be an objection filed, even if the creditor is unhappy about the venue. Indeed, it is very easy to imagine a scenario in which many creditors are unhappy about the venue chosen by the debtor but do not object because the costs of the objection outweigh the benefits.

Consider a scenario in which a venue challenge would cost $50,000. No creditor will bring such a challenge unless it knows it will get at least $50,001 worth of benefit. This means there could be many creditors who would get $49,000 worth of benefit, but none would bring the motion. Added up, this could be a lot of money—with a thousand such creditors, there is $49 million in harm, and yet no objection would be forthcoming to the venue.

If these creditors are not adequately represented by the Unsecured Creditors' Committee (which is quite possible and is an issue itself affected by choice of forum), the

[11] *See* LYNN M. LOPUCKI, COURTING FAILURE: HOW COMPETITION FOR BIG CASES IS CORRUPTING THE BANKRUPTCY COURTS (2006).

[12] The sensible location for such a single venue would be Washington, D.C.

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motion will not be made.[13] Even if a venue motion had positive expected net present value, a creditor might not want to pay for a venue objection because the benefits would be shared with all the other creditors. Why not let someone else pay the freight?

Creditors' value calculation about whether to object about venue is further complicated because the benefit (and even location) of a different venue is uncertain. Even if a particular venue is improper, the creditor does not know what venue the debtor would then select, and the law in that jurisdiction might be unsettled, making the benefit of transferred venue uncertain. What this means is that lack of venue objection cannot be interpreted as consent. It just means that creditors do not think the benefits of an objection outweigh the costs.

V. Conclusion

Bankruptcy venue is ultimately a substantive issue, as the ability to forum shop affects both the applicable law and the amount of the professional fee claims in a case. I urge the Committee to reform the bankruptcy venue system to eliminate forum shopping, either by centralizing all large filings in one district or by requiring filing in the district in which a firm's nerve center is based.

Sincerely,

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[13] The creditors could proceed as an unofficial *ad hoc* committee, but that poses coordination problems and Rule 2019 disclosure requirements that creditors may wish to avoid.

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