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Cause for Reform: The Bankruptcy Venue Reform Act of 2021

Shopko... Briggs & Stratton... Appvion (formerly Appleton Papers)... Harnischfeger... Bon-Ton... JHT Holdings... Arandell... Golden Guernsey Dairy. We tend to think of these companies as our own—Wisconsin-based, some with storied traditions here, employers of family members and friends—but all of them have one thing in common: they filed for bankruptcy protection in another state. Recently proposed congressional legislation aims to reduce the number of such extraterritorial filings.

Current Bankruptcy Venue Law

The venue, or location of a corporate bankruptcy case is currently governed by section 1408 of the Judicial Code, 28 U.S.C. § 1408. It allows companies to file a bankruptcy petition: (1) where the entity has been domiciled (incorporated) or had its principal place of business or principal assets for at least 180 days immediately preceding the filing (or the longest portion of such 180-day period if more than one location is implicated); and (2) where there is a pending case filed by an affiliate, general partner or partnership. Imagine a large corporation, headquartered, incorporated and with a principal place of business in Texas, that has 50 subsidiaries and affiliates, one of which happens to be incorporated in Delaware. In an all-too-common scenario, that subsidiary, otherwise insignificant to the overall operation of the business, files a bankruptcy petition with the U.S. Bankruptcy Court for the District of Delaware. As of that moment, the “affiliate” has a case “pending” in Delaware, and all other 50 “affiliates” of that debtor may immediately file their own bankruptcy petitions in Delaware.

This is not the way our judicial system typically determines the appropriate venue for a dispute. Most civil cases must be filed in the location where the significant events giving rise to the dispute occurred. Bankruptcy proceedings are admittedly more collective in nature than ordinary civil litigation, with parties-in-interest extending well beyond traditional plaintiffs and defendants, but there is still good reason to expect that bankruptcy cases will be filed in the debtor's "home" state. Over the last two decades, studies on bankruptcy venue reform have been done, and several bills have been proposed, but each has stalled in the congressional politics of the day. For example, today's proponents of reform understandably express concern that President Biden hails from Delaware, the most popular

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venue for large corporate reorganizations. Any bankruptcy venue legislation will have to be signed by the president to become law. But the longer the debate goes on, and the more cases that are filed outside a debtor's home state, the louder the cries for venue reform.

Problems with Current Bankruptcy Venue Law

Proponents of venue reform often express concern for the protection of employees and local business creditors who cannot easily appear in a case or afford counsel hundreds or thousands of miles away from the home state. Indeed, the practical effect of current law is that a handful of out-of-state judges are frequently deciding how thousands of Wisconsin creditors, retirees, employees, regulators and customers will be treated, when judges in the state have all of the necessary expertise and could decide the issues—particularly those that implicate Wisconsin law—in a less abstract way, with more prevalent local media coverage. If you are a creditor that has the misfortune of being sued in a bankruptcy case (it happens more than one would think), you'll have little choice but to hire legal counsel in the (often expensive) filing jurisdiction and travel there as necessary. Delaware, for example, requires every party appearing in a case to retain a lawyer both licensed to practice and present in the state. Remarkably, all but two of the Wisconsin cases mentioned above were filed in the District of Delaware.

The potential for abuse is also a significant concern. Consider Purdue Pharma, a company headquartered in Connecticut (and with principal manufacturing plants in Rhode Island and North Carolina), maker of OxyContin, that pleaded guilty to criminal charges associated with the opioid epidemic. The company filed for bankruptcy protection in White Plains, New York, arguably to take advantage of law that offered more favorable treatment for its shareholders. Or consider the Delaware bankruptcy filing by the Boy Scouts of America (BSA). The BSA is headquartered in Texas, with significant assets in a number of jurisdictions, but its sole connection to Delaware appeared to be a subsidiary created seven months before the bankruptcy filing.

The economic impact of these bankruptcy filings is significant. Corporate reorganizations are, let's face it, big business. Large, corporate cases provide tens of thousands of hours of work for the many professionals who are sure to be engaged in them. Financial advisers, appraisers, attorneys, investment bankers, brokers, liquidators, expert witnesses, court reporters, turnaround experts and accountants may all play a role. And when a Wisconsin company files bankruptcy

elsewhere, many of those professionals will lose their engagements to others more local or more connected in other ways to the filing jurisdiction. The loss of this trickle-down, home-state business cannot be understated, even for industries such as transportation, food and hospitality, because not every professional or creditor will be local in any given case.

One could debate the reasons for the clustering of cases in a handful of jurisdictions, but suffice it to say, once there was momentum, it snowballed. Judges in the most popular jurisdictions gained experience in handling large cases, developed procedures perceived to be debtor-friendly, and developed law that, when favorable to debtors, could be used again and again with predictability in future cases.

No wonder that, from the debtors' perspective, these "magnet" jurisdictions provide predictability of outcome, efficiency in process (the cases tend to move quickly in these courts) and leniency on high professional billing rates. Politics aside, there is little doubt that the bunching of cases in such jurisdictions has had a dramatic impact on bankruptcy practice around the country.

The Bankruptcy Venue Reform Act of 2021

To address these problems, U.S. Senators Elizabeth Warren (D-Mass) and John Cornyn (R-Texas) recently introduced the Bankruptcy Venue Reform Act of 2021, a bill that was previously introduced in the House of Representatives. The bill would eliminate the domicile (state of incorporation) provision and limit the "affiliate" provision to parent companies—ones that directly or indirectly own, control or hold 50 percent or more of the outstanding voting securities of (or is the general partner of) the entity that filed the later case.

In other words, the proposal limits choice of bankruptcy venue to locations of the principal place of business or principal assets of the company (with the same 180-day prerequisite), or locations where a parent or general partner (as described above) has a case pending. For public companies, the "principal place of business" is defined to mean "the address of the principal executive office of the entity as stated in the last annual report filed" under the Securities Exchange Act of 1934.

The proposed legislation labels the practice of filing large cases outside the home state "forum shopping," which has resulted in a concentration of large bankruptcy cases in a limited number of districts around the country. Warren and Cornyn note that in the last 20 years, more than 70 percent of public companies with at least $100 million in assets filed for bankruptcy protection in a district outside the

one closest to their headquarters. Indeed, it is little secret that the most frequently used jurisdictions are Delaware, the Southern District of New York, the Southern District of Texas and the Eastern District of Virginia.

The bill includes a finding that forum shopping "prevents small businesses, employees, retirees, creditors and other important stakeholders from fully participating in bankruptcy cases that have tremendous impacts on their lives, communities and local economies" and deprives courts of the "opportunity to contribute to the development of bankruptcy law" in their jurisdictions. Reducing forum shopping in the bankruptcy system, according to the proposal, "will strengthen the integrity of, and build public confidence and ensure fairness in, the bankruptcy system."

The legislation also has teeth. No effect will be given to changes in the ownership or control of the debtor or its affiliate, or to transfers to another district of the principal place of business or assets, that take place within one year before the bankruptcy filing or for the purpose of establishing venue. Similarly, the term "principal assets" does not include cash or cash equivalents and debtors bear the burden of proving that venue is proper by clear and convincing evidence.

Cause for Reform

The Bankruptcy Venue Reform Act of 2021 appears to have bipartisan support and the legislation tackles the issues head-on. By ending the manipulation of bankruptcy venue, Congress will ensure a more even distribution of cases around the country, resulting in a better utilization of available judicial resources. In turn, public confidence in our bankruptcy system and diversity of thought stand to improve. If you are looking for a laudable proposal out of Washington, this is a good one to watch and support.

Reinhart's Business Reorganization team has a great deal of depth and experience handling insolvency matters. Please contact Frank DiCastri or any member of the team if you have questions.