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Legal Sidebar

Should Federal Law Restrict Where a Company May File Bankruptcy?

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Commentators, citing "the large concentration of business bankruptcies" filed in New York and Delaware to the exclusion of other jurisdictions, have debated for several decades whether Congress should reduce the flexibility that many companies currently enjoy when selecting where to file bankruptcy. Critics maintain that the current bankruptcy venue rules—many of which offer large companies a wide range of forums in which they may permissibly file bankruptcy—encourage debtors to forum-shop for jurisdictions that favor debtors and their attorneys to the detriment of creditors and other stakeholders. Supporters of the existing venue rules, by contrast, argue that concentrating large business bankruptcies in a small number of forums allows judges and attorneys in those jurisdictions to develop extensive expertise and experience with complex bankruptcy matters, thereby benefiting debtors, creditors, and stakeholders alike.

These debates form the backdrop for the Bankruptcy Venue Reform Act of 2018 (S. 2282), a bill that would restrict the venues in which a business entity may validly file bankruptcy. This Sidebar situates this bill within the ongoing policy debate over the bankruptcy venue rules and analyzes how the bill could potentially affect the bankruptcy system if ultimately enacted.

Bankruptcy Venue

In its current form, 28 U.S.C. § 1408 allows a debtor to file bankruptcy in any bankruptcy court in which the debtor's (1) principal place of business; (2) principal assets; (3) domicile (i.e., its state of incorporation); or (4) residence has been located during the 180-day period preceding the bankruptcy filing, or in any district in which a bankruptcy case concerning the debtor's affiliate, general partner, or partnership is pending.

As a result of 28 U.S.C. § 1408, corporations and other large business entities often have several options when deciding where to file bankruptcy. For instance, as the Government Accountability Office noted in a September 2015 report, "a company headquartered in Los Angeles may be incorporated in Delaware, maintain its assets in New York, and have affiliates with pending bankruptcy proceedings in Chicago, allowing the company to file bankruptcy in any of these locations."

Although the Federal Rules of Bankruptcy Procedure sometimes permit a court to transfer a bankruptcy case to a district other than the one the debtor has selected—such as when the debtor improperly filed the

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case in a venue not authorized by 28 U.S.C. § 1408, or when the court determines that transferring the case "is in the interest of justice or for the convenience of the parties"—courts "generally grant substantial deference to a debtor's choice of forum." As a result, debtors, rather than creditors or other stakeholders, typically get to select the court in which the bankruptcy case will proceed.

Advantages and Disadvantages of the Current Bankruptcy Venue Rules

As a consequence of the flexibility that debtors currently enjoy when choosing where to file bankruptcy, a small number of bankruptcy courts—specifically the U.S. Bankruptcy Courts for the District of Delaware and the Southern District of New York—have become hubs in which large corporate debtors frequently opt to file their bankruptcy petitions. Oftentimes, a business that files bankruptcy in New York or Delaware does not maintain its headquarters or principal place of business in either of those states, yet the business nonetheless remains eligible to file in one or both of those states because it is incorporated there or because one of its affiliates has filed for bankruptcy there.

In reaction to the concentration of large business bankruptcies in a small number of venues—venues that may or may not otherwise have a particularly significant connection to the debtor's creditors, employees, or stakeholders—commentators have extensively debated whether to restrict debtors' ability to file bankruptcy in a forum of their choice.

As noted, supporters of the existing venue rules argue that, when large bankruptcy proceedings are concentrated in a small number of courts, judges and attorneys in those jurisdictions develop robust expertise and experience with complex corporate bankruptcy issues. This collective experience can arguably promote "certainty and predictability" and allow difficult and complicated cases to be resolved more quickly, which may benefit debtors and creditors alike. Supporters maintain that New York and Delaware in particular "are typically convenient for most businesses' financial creditors, have expertise in complex financial and operational matters, and have relatively efficient procedures for handling large cases." They argue that limiting a debtor's options with respect to venue—and thereby requiring more debtors to file bankruptcy in states other than New York or Delaware—might result in difficult and consequential bankruptcy issues being decided by judges with comparatively less experience managing complex reorganizations than their New York and Delaware counterparts.

"Critics of the existing venue statute," by contrast, argue that 28 U.S.C. § 1408's flexibility undesirably allows debtors to "file cases in jurisdictions thousands of miles away from the company's management, employees, communities and key constituencies," such as when the debtor files in its state of incorporation rather than in the state where it conducts most of its operations. According to critics, this geographical distance makes it "difficult and expensive" for "smaller parties, such as employees and small business creditors, to participate in the bankruptcy process." Some critics also argue that, when debtors have substantial flexibility to choose the jurisdiction in which they file bankruptcy, self-interest encourages those debtors to file in courts that favor debtors and their attorneys to the detriment of creditors and other stakeholders.

The Bankruptcy Venue Reform Act of 2018

The Bankruptcy Venue Reform Act of 2018 has been introduced in the 115th Congress, which would narrow the range of venues in which a company may permissibly file bankruptcy. If enacted, the bill would, among other things:

- Restrict the venues in which a non-individual debtor (such as a corporation or limited liability company) may validly file bankruptcy to the forums in which the debtor's "principal place of business" or "principal assets" are located, thereby prohibiting companies from filing bankruptcy in a particular venue "simply on the basis of their state of incorporation" alone.
- Replace 28 U.S.C. § 1408(2), which currently permits a debtor to file bankruptcy in any district in which a bankruptcy case concerning the debtor's "affiliate, general partner, or partnership" is pending. In its place would be a provision that would allow a debtor to file bankruptcy in the same venue as an affiliate only if (1) the affiliate "directly or indirectly owns, controls, is the general partner, or holds 50 percent or more of the outstanding voting securities" of the debtor; and (2) that affiliate's pending bankruptcy case "was properly filed in that district." This provision would thereby limit a company's ability to file bankruptcy in a venue "simply because an affiliate of the debtor has filed there."
- Place the burden on the debtor to "establish[] by clear and convincing evidence that venue is proper," rather than placing the burden on the creditors or other interested parties to show that the court should transfer the case to another venue.
- Abrogate Federal Rule of Bankruptcy Procedure 1014, which currently provides that a bankruptcy court "*may*" transfer a bankruptcy case that has been filed in an improper venue to a different forum, and replace it with a statutory provision that affirmatively *requires* the court to transfer or dismiss a case that is "filed in the wrong division or district," and further requires the bankruptcy court to rule on any pending motion to change a bankruptcy case's venue within 14 days.

The bill's sponsors argue that "closing the loophole that allows corporations to 'forum shop' for districts sympathetic to their interests will strengthen the integrity of the bankruptcy system and build public confidence." Opponents of the bill, however, contend that "experienced bankruptcy judges are critical to ensuring that companies can restructure in a way that saves jobs and preserves value" and that "scrapping the venue laws that have been in place for decades . . . flies in the face of well-settled principles of corporate law, threatens jobs, and hurts our economy."

As of the date of this publication, the bill is pending before the Senate Committee on the Judiciary.

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