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Legal Sidebar

Congress Considers Making it Harder to File for Bankruptcy in New York or Delaware

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Commentators, citing the significant 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 for 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 for bankruptcy—encourage debtors to file for bankruptcy in courts 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 few forums allows judges and attorneys in those jurisdictions to develop extensive expertise and experience with complex bankruptcy matters, benefiting debtors, creditors, and stakeholders alike.

Past Congresses have reacted to this debate by proposing to restrict the venues in which a business entity may validly file for bankruptcy. Most recently, the 116th Congress introduced the Bankruptcy Venue Reform Act of 2019 (H.R. 4421), which aims "to prevent the practice of forum shopping" in business bankruptcy cases. This Sidebar situates this bill within the ongoing debate over the bankruptcy venue rules and analyzes several ways Congress could influence where businesses file for bankruptcy.

Bankruptcy Venue

28 U.S.C. § 1408 currently allows a debtor to file for bankruptcy in any bankruptcy court where the debtor's (1) principal place of business, (2) principal assets, (3) domicile (which, in the case of a corporate debtor, is its state of incorporation), or (4) residence has been located during the 180-day period preceding the bankruptcy filing. Section 1408 further authorizes debtors to file for bankruptcy in any district in which a bankruptcy case concerning the debtor's affiliate, general partner, or partnership is pending. Section 1408 thereby provides large business entities a range of options when deciding where to file for bankruptcy.

Current law permits (but does not require) a court to transfer a bankruptcy case to a different forum in some cases, such as when the debtor improperly filed the 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." However, a party seeking to transfer a bankruptcy case bears the burden to

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prove that the debtor filed its case in an improper forum, and courts "generally grant substantial deference to a debtor's choice" regarding where to file suit. As a result, debtors, rather than creditors or other stakeholders, typically select the court in which their bankruptcy case will proceed.

By granting debtors a fairly broad degree of flexibility to choose where to file for bankruptcy, Section 1408 has resulted in a few bankruptcy courts—especially the U.S. Bankruptcy Courts for the District of Delaware and the Southern District of New York—to become hubs for major bankruptcy cases. One recent empirical study, for instance, suggests that over 60% of large business debtors filed for bankruptcy in these two forums. According to supporters of the existing venue rules, debtors prefer the New York and Delaware bankruptcy courts because they are especially "convenient for most businesses' financial creditors, have expertise in complex financial and operational matters, and have relatively efficient procedures for handling large cases." Those who oppose the existing rules, however, instead claim that these courts are overly willing to award generous professional fees to debtors' attorneys, incentivizing attorneys to push their clients to file there.

Oftentimes, a business that files for bankruptcy in New York or Delaware does not maintain its headquarters or principal place of business in either of those locations, yet still remains eligible to file in one of those venues because it is incorporated there or because one of its affiliates has filed for bankruptcy there. For instance, despite being a Texas-based company incorporated in Oregon that employed a substantial number of workers in Houston, Enron filed for bankruptcy in New York, where one of its New York subsidiaries had filed for bankruptcy. Similarly, "[m]any companies are incorporated in Delaware and can therefore file in that state," "even if neither the company nor its creditors have any other connections to Delaware."

In reaction to the concentration of large business bankruptcies in a few venues that may not otherwise have a particularly significant connection to the debtor's creditors, employees, or stakeholders, commentators have extensively debated whether to amend 28 U.S.C. § 1408. Supporters of the existing venue rules argue that concentrating large bankruptcy proceedings in a small number of courts allows judges and attorneys in those jurisdictions to develop robust expertise and experience with complex corporate bankruptcy matters. This collective experience, supporters argue, can promote "certainty and predictability" and allow courts and interested parties to resolve bankruptcy cases more quickly to the benefit of debtors and creditors alike. According to those favoring the status quo, 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 in managing complex business reorganizations.

Critics of the existing venue statute, by contrast, argue that Section 1408 permits debtors to "file cases in jurisdictions thousands of miles away from the company's management, employees, communities and key constituencies." According to critics, this geographical distance makes it difficult and expensive for smaller stakeholders, such as employees and small business creditors, to meaningfully participate in the bankruptcy process. Some critics also argue that, when debtors have substantial flexibility to choose the jurisdiction in which they file for bankruptcy, self-interest encourages those debtors to file in courts that favor debtors and their attorneys to the detriment of creditors and other stakeholders. For instance, critics maintain that debtors' attorneys push their clients to file for bankruptcy in courts that apply debtor-friendly legal precedent or do not rigorously scrutinize attorneys' requests for professional fees. Moreover, some scholars, citing statistics suggesting that companies that file for bankruptcy in New York or Delaware fail to successfully reorganize at higher rates than companies that file elsewhere, dispute the argument that New York and Delaware bankruptcy courts are better equipped to preside over major bankruptcies than their counterparts in other states.

Legal Considerations for Congress

The 116th Congress has weighed in on this ongoing debate by introducing the Bankruptcy Venue Reform Act of 2019 (H.R. 4421) (Act). Among other things, the Act would narrow the range of venues in which a company may permissibly file for bankruptcy by:

- Eliminating the provision of 28 U.S.C. § 1408 that authorizes business debtors to file for bankruptcy in the forum in which they are domiciled—that is, in their state of incorporation.
- Modifying 28 U.S.C. § 1408(2), which permits debtors to file for bankruptcy in any district in which a bankruptcy case concerning the debtor's "affiliate, general partner, or partnership" is pending. The Act would replace Section 1408(2) with a provision that would allow a debtor to file for bankruptcy in the same venue as an affiliate only if the affiliate both (1) "directly or indirectly owns, controls, or holds 50 percent or more of the outstanding voting securities of, or is the general partner of," the debtor and (2) filed for bankruptcy in a venue permitted by the Act.
- Discouraging forum shopping by prohibiting debtors from filing for bankruptcy in any forum to which the debtor has strategically relocated its principal place of business or principal assets during the year preceding its bankruptcy filing.
- Shifting the existing burden of proof by placing the burden on the *debtor* to establish by "clear and convincing evidence" that it filed its bankruptcy case in a proper forum.
- Altering the current permissive venue scheme by mandating that the court "*shall*" dismiss or transfer any bankruptcy case filed in a forum that is improper under the Act.
- Requiring bankruptcy courts to rule on parties' objections to the debtor's choice of venue within 14 days.

As of the date of this Sidebar, the Act is pending in the House of Representatives.

Directly modifying the applicable venue rules is not the only way Congress could attempt to influence where businesses file for bankruptcy. One scholar, for instance, advocates creating a single United States Court of Appeals for Bankruptcy with exclusive jurisdiction over appeals from bankruptcy courts across the country, much like the United States Court of Appeals for the Federal Circuit's exclusive jurisdiction over patent appeals. This scholar reasons that debtors' attorneys persuade debtors to file in New York and Delaware because they perceive those jurisdictions as having especially debtor-friendly judicial precedents. If, however, Congress funneled all bankruptcy appeals to a single, specialized appellate court, that court's precedent would bind every bankruptcy court in the country, mitigating doctrinal deviations between individual jurisdictions. Then, argues this scholar, debtors would have less incentive to file for bankruptcy in distant jurisdictions in search of more favorable case law. Still other scholars, proceeding on the premise that bankruptcy attorneys encourage their clients to file large bankruptcy cases in New York and Delaware because they perceive those courts as particularly willing to approve generous professional fees, have argued that Congress could reduce incentives to file bankruptcy cases in those forums by capping or otherwise limiting such fees.

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