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Feature

By Andy Dietderich

"Confessions" of a Forum-Shopper: Part I

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The board of directors of a large corporation considering chapter 11 will have some discretion as to where to file the case. The rules do not provide a board with complete flexibility but usually generate a number of viable choices. Popular options include New York (downtown or the suburb of White Plains), Houston and Wilmington, Del.

Many commentators and creditor-side professionals seek to eliminate this discretion. Critics of current venue rules argue that corporations too often file far away from their headquarters, intentionally creating hardships for employees and local trade creditors. Critics also argue that "regulatory competition" encourages judges to agree with the position of debtor's counsel on substantive matters in order to attract additional large corporate cases in the future. These concerns support the recent introduction of legislation to require all debtors to file for chapter 11 only in the jurisdiction in which their parent company's principal place of business or principal assets are located.[1]

Anytime the law lets fiduciaries exercise discretion, some people will abuse that discretion. Others will use the discretion appropriately and for appropriate ends. Like colleagues at many firms, I have considered venue most often when representing corporations considering chapter 11. These corporations did not correspond to the pervasive archetype of puppet to a private-equity owner-villain intent on cheating workers, tort victims and bondholders, nor the equally pervasive archetype of intimidated managers ready to rubber-stamp any demand by secured creditors in exchange for liability releases. The clients have been real corporations led by real managers overseen by real directors, and the debtor team has had a *bona fide* desire to restructure the corporation's balance sheet — and sometimes its underlying business operations — in order to preserve value and jobs. It might be a controversial position, but while helping them, I have come to believe strongly that some flexibility to forum-shop is, on balance, a very good thing for American bankruptcy law. In fact, forum-shopping can be *essential* to restructure a business successfully, especially in challenging cases where the going concern is at risk. This article explains why, and offers some related thoughts on the policy debate from the corporate debtor's perspective.

Part I addresses forum-shopping within the U.S. by domestic corporations. Part II, to be published in a later issue, will address international forum-shopping among U.S., U.K. and other jurisdictions.

Forum-Shopping to Preserve Assets

As every bankruptcy practitioner knows, the Bankruptcy Code is a federal statute that leaves many issues open for the courts to decide. Variance in case law is the first and most important reason why corporate debtors forum-shop. Appellate, district and bankruptcy courts around the nation interpret the Code in different ways, and a well-advised corporate debtor will file in whatever available forum has *the best legal precedent for its reorganization purpose*.

One example is the use of the "actual" or "hypothetical" test to determine whether a reorganizing debtor can assume a contract in accordance with § 365(c) of the Bankruptcy Code. Sometimes a corporate debtor derives a meaningful part of its revenue from in-bound patent licenses, concession contracts or other contracts that are not assignable without counterparty consent. If the debtor has its headquarters in New Jersey, Delaware or California (three among many examples), it may be impera-

1 *See* Bankruptcy Venue Reform Act of 2021, H.R. 41931, proposed by Rep. Zoe Lofgren (D-Calif.) and Ken Buck (R-Colo.). Its stated purpose is to "prevent the practice of forum shopping." *See* § 2(b). It would do so chiefly by eliminating a debtor's ability file in the district where it is organized (*e.g.*, Delaware) or where an affiliate has filed.

tive to "forum shop" to a venue such as New York or Texas. Why? To avoid the wasting corporate assets. If the corporation files at its headquarters, it could lose the revenue from these contracts unless the counterparty consents.[2] If the corporation files in New York or Texas, the contracts will continue through the reorganization as long as the corporation otherwise treats the counterparty fairly as required by the Bankruptcy Code.

This issue became pertinent in one situation. The debtor's headquarters were in a "hypothetical test" district that would not permit assumption of highly material contracts. A pre-arranged reorganization plan that impaired financial creditors was sought, but it left nonfinancial creditors unimpaired. In negotiations with financial creditors, the debtor believed that the debtor could obtain sufficient votes for such a plan *only* by ensuring a reasonably prompt and certain chapter 11 case (*i.e.*, not a "free fall"). To provide those assurances, it required billions of dollars of exit-financing commitments prior to filing. The business was in a volatile industry that is difficult to finance, and these commitments could only be obtained if investors were certain that the material contracts would continue through the chapter 11 process.

The corporation had a subsidiary in a district where bankruptcy law would permit the assumption of these contracts as of right. So, using the flexibility under the current venue rules, they filed in that district (not at the corporate headquarters) to lock down the necessary underwriting commitments and timetable. Since an attractive timetable and risk profile for the case could be delivered, counsel extracted from financial creditors the requisite vote for a reorganization plan that paid significant employee and general unsecured creditors *in full* — despite the financial creditors receiving a more than 90 percent haircut on their own unsecured claims. The dynamics that permitted this negotiated result are complicated, but the ability to move quickly through the case in the chosen venue was the primary "carrot" that could be offered the consenting financial creditors.

Venue reform, as currently proposed, would have deprived them of this reorganization strategy. It would have required them to file for chapter 11 in the jurisdiction of its corporate headquarters, putting critical contracts at risk and preventing the pre-arranged case that counsel had been working hard to conclude. Given the complexity of this particular capital structure, the resulting "free fall" chapter 11 case would have been exponentially more expensive for everyone and disastrous for the general unsecured creditors the plan left unimpaired.

Forum-Shopping to Save Jobs

Other differences in applicable law lead to forum-shopping in operational reorganizations, where reductions in footprint and workforce might be necessary for the business to continue as a going concern. These are rewarding cases, but challenging. When downsizing is a possibility, it might surprise some critics of the debtor practice to hear that corporate directors do not naturally respond by instructing counsel to develop a plan that enriches institutional investors at the expense of employees, independent contractors and small businesses. Management and directors can be far more likely to express a heartfelt desire to preserve franchise value and avoid imprudent force reductions. In some circumstances, this objective becomes an important part of the design of the chapter 11 plan.[3]

One legal issue that can influence what happens to employees in some industrial restructurings is the priority of rank-and-file worker severance. In many jurisdictions around the nation, severance rules are unfavorable for workers. Specifically, if a debtor terminates an employee during the chapter 11 case, the employee will have an unsecured claim for severance, except to the extent of time actually worked during the case. If a worker has spent 20 years at a firm and earned the right to receive six months of severance upon termination, most bankruptcy courts will regard virtually all of that claim as unsecured. In modern capital structures, where financial creditors hold a blanket lien on most of the debtor's assets, a common result is that severance for experienced workers goes largely unpaid, even if the business continues as a going concern in the hands of new owners.[4]

In New York, the rule is different. The Second Circuit Court of Appeals held in the late 1960s that when a debtor terminates a worker during a bankruptcy case, the entitlement to severance is a cost of the reorganization.[5] Accordingly, the worker's claim for earned severance is more likely in New York to have an administrative priority over pre-petition creditors and be payable in full in cash.

Therefore, a corporate debtor facing material severance expense and contemplating chapter 11 has an interesting choice to make. Let's assume that the debtor is headquartered in a jurisdiction where severance would be an unsecured claim (Los Angeles, Chicago, Houston and Delaware all qualify), but has a potential basis for venue in New York. A filing at headquarters reduces the bargaining position of workers and could *encourage* layoffs if secured creditors view the chapter 11 case as a "window of opportunity" to terminate workers without paying promised severance. On the other hand, although a filing in New York might *discourage* layoffs, it will increase the costs of the reorganization and create incremental administrative claims if layoffs occur.

There is no right or wrong choice, as it depends on the facts. I have seen corporate debtors in this situation file in New York after concluding that severance is affordable and critical for their reorganization purpose. The New York severance rule can be especially valuable if a debtor aims to reorganize and downsize simultaneously during the case. Such a debtor can reasonably conclude that it *needs* the New York rule to overcome reflexive hostility to severance, reinforce its efforts to motivate employees, and encourage full employment at the portion of its operations it intends to preserve.[6] In at least two cases, venue in New York has helped avoid the premature liquidation of business units and preserved thousands of jobs — jobs that continue today.

2 Reorganizations might be impossible if counterparties, seeing an opportunity for a windfall, refuse to consent to the continuation of otherwise unavoidable contracts that they regret or wish to reprice.

3 Corporate fiduciary duties permit a focus on job preservation for long-term value. Job preservation is a central policy objective of the Bankruptcy Code.

4 The "priority" claim of up to $13,650 per employee for wages, salaries, commissions, vacation, severance and sick leave under 11 U.S.C. § 507 is junior to the claims of secured creditors (to the extent of their collateral) and administrative claims.

5 *Straus-Duparquest Inc. v. Local Union No. 3, Int'l Brotherhood of Elec. Workers*, 386 F.2d 649 (2d Cir. 1967). The case has its critics, but it is still good law. *See In re Spectrum Information Techs. Inc.*, 193 B.R. 400, 407 (Bankr. E.D.N.Y. 1996)).

6 Ultimately, most New York debtors with a substantial employee base will implement a court-approved severance program, negotiated against the backdrop of the New York rule.

Is Forum-Shopping Good or Bad?

These are merely two examples of principled forum-shopping. The application of bankruptcy law varies around the nation in other important ways. Any bankruptcy lawyer who has worked closely with debtors prior to filing will have her/his own forum-shopping stories.

In light of the diversity of legal applications around the nation, Congress should not eliminate venue choice without understanding how it affects the ability of corporate debtors to reorganize in challenging cases. Of course, Congress could mitigate the effects of a prescriptive approach if it resolved the circuit splits. However, to do this, Congress would need a uniform rule for each open issue, and circuits split for a reason. U.S. bankruptcy courts vary, not with respect to every issue, but with respect to the specific issues that are *not ready* for uniform rules: issues where neither Congress nor the U.S. Supreme Court has spoken, and judges, academics and practitioners have yet to build a consensus. Bankruptcy jurisprudence, with its mix of law and equity, might advance best by case law — not statute. The Bankruptcy Code is, in many respects, a codification of prior case law, highly influenced by seminal judicial opinions and the reaction to those opinions over time.

If bankruptcy law continues to vary by venue (but the law in each venue is still fundamentally viable), forum-shopping has two positive social effects. First, forum-shopping provides a debtor with a bigger legal toolbox with which to reorganize based on the circumstances of its case. Modern corporations have many opportunities to choose among legal rule sets, such as decisions on where or in what form to incorporate a subsidiary. As long as the corporation chooses for good reasons consistent with its fiduciary duties, choice itself is a social good that will help achieve whatever valid objective the corporation is pursuing.[7]

The second social benefit of forum-shopping is that it can increase efficiency and predictability. These are helpful when the debtor seeks pre-filing financial commitments. The availability and cost of commitments will depend, in part, on investor comfort with the restructuring timetable and implementation risk. Professionals can give better advice to decision-makers about the likely outcome of a case in a venue with clear precedent on key issues. In addition, the familiarity of a particular bankruptcy court and professional community with special issues (*e.g.*, oil and gas valuation) can increase predictability and shorten the timetable. The desire to provide certainty to financial stakeholders is the primary reason why large cases have been concentrated in relatively few districts over time.[8]

All of the advantages of forum-shopping by the debtor assume good corporate governance. Sometimes venue is a conflict matter, such as when the choice of venue has a material effect on the resolution of claims against controlling owners. However, a potential conflict of interest is no reason to take away corporate authority. Corporate debtors decide when, if and how to file for chapter 11, and choose among permitted alternatives for the reorganization plan. The choice of venue is just a small part of the overall plan. U.S. law decided long ago that when it comes to the development of the reorganization plan, management is the least worst option. This is why bankruptcy law relies on state law fiduciary duties to police corporate decision-making and provides remedies if the board violates those fiduciary duties, including preservation of state law causes of action and the denial of relief sought in bankruptcy court. Whether one believes bankruptcy courts are or are not doing enough to enforce these state law fiduciary duties, there is no reason why the choice of venue is different as a corporate governance matter from the debtor's other actions in pursuit of a successful reorganization.

Conclusion

Recognizing that forum-shopping *can* be healthy does not imply that the current system of modified venue choice is anywhere near perfect. Congress or the Supreme Court could establish national rules on more of the issues that policy-makers fear drive venue decisions that benefit insiders, such as third-party releases of controlling owners. Congress could change the procedure for bankruptcy appeals to increase both the number of appellate decisions and their uniformity. District courts could review the assignment system for bankruptcy judges within their districts to ensure that it is fair and perceived as fair by the public. The U.S. Trustee Program could review its national professional fee guidelines to ensure uniform application. Courts could let practitioners know more clearly that they are ready to dismiss cases where venue choices unfairly defeat the vested expectations of certain creditors. Courts could develop new ways to encourage individual and small business creditors to participate, including by continuing pandemic-period use of telephone and video (perhaps at reduced fees). For that matter, Congress could provide workers and small business creditors with additional economic rights under the Bankruptcy Code. This article advocates for none of these in particular, but each would address a policy concern motivating venue reform without inadvertently making restructuring harder for debtors by prescribing exactly where they must file.

So long as the law is diversely applied, the future is unknown and boards are loyal fiduciaries, a little forum-shopping now and then is a good thing. abi

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7 Some academics propose that each corporation choose a chapter 11 venue in advance in its corporate charter. *See, e.g.*, Anthony J. Casey & Joshua C. Macey, "Bankruptcy Shopping: Domestic Venue Races and Global Forum Wars," 37 *Emory Bankruptcy Developments Journal* 101, 135-8 (2021) (discussing prior proposal by Robert K. Rasmussen and Randall S. Thomas). This would be better for debtors than prescribing venue at the principal place of business. However, no corporation starts life accurately planning for its own restructuring; a corporate debtor is unlikely to know the best venue for its chapter 11 case until it decides what it wants to accomplish in the case.

8 There is consistent evidence from the financial markets. *See* Jared A. Ellias, "What Drives Bankruptcy Forum Shopping? Evidence from Market Data," 47 *J. Legal Stud.* 119 (2018) (investors predict case outcomes more accurately in common venues for large filings). For practitioners, however, the most predictable forum is not always Delaware, New York or Houston. There are great bankruptcy courts — and great bankruptcy *opinions* — all around the nation.