Give Credit to Good Courts

Joseph R. Biden Jr.
Legal Times
06-20-2005

On June 6, Sen. John Cornyn (R-Texas) published a commentary in Legal Times titled "They Owe Us: Companies Seeking Bankruptcy Relief Should Face Creditors in Their Home Court" (Page 6). The article argues that the U.S. Bankruptcy Code should be stripped of the provision that has allowed companies to file for bankruptcy in the state of their incorporation. It resurrects old studies and rehashes unsubstantiated allegations, making an argument that has been repeatedly rejected by Congress and academic experts.

The fact of the matter is, the venue rules in bankruptcy cases are based on a good policy that works well for all involved.

One of the states that Sen. Cornyn singled out for criticism is my state of Delaware, a jurisdiction widely respected for the quality, efficiency, expertise, and fairness of its bankruptcy courts.

A LONG-STANDING POLICY

Reading Sen. Cornyn’s commentary, one might be tempted to conclude that the current bankruptcy venue provision is somehow unusual or atypical in American law. The commentary suggests that the ability to file for bankruptcy in jurisdictions other than the location of the company’s headquarters or principal assets is a “loophole,” permitting companies to “manipulate” the system.

In fact, some form of this venue provision has been on the bankruptcy books for 102 of the past 107 years, including the past 27. During the 1970s, Congress briefly experimented with changing it, but quickly determined that the historic standard was the right one. Moreover, a company’s state of incorporation is a proper venue under many other federal statutes, including the patent laws, the antitrust laws, the securities laws, and Superfund.

Sen. Cornyn claims that venue-shopping is rampant. In fact, venue-shopping is relatively rare. Over the past 15 years, more than 80 percent of the companies that could have filed their Chapter 11 cases in Delaware declined to do so.

Sen. Cornyn suggests that the current bankruptcy venue rules are illogical and inflexible. To the contrary, the venue rules make eminent sense and are flexible enough to adjust to different circumstances. Indeed, they provide for venue to be transferred "in the interest of justice or for the convenience of the parties," a consideration that carries real weight with the courts. Delaware courts, in particular, grant two out of three motions to transfer to another venue.

FAULT LIES WITH ENRON

In making his argument for changing the venue rules, Sen. Cornyn points to several recent high-profile bankruptcy cases that, he posits, demonstrate the failings of the venue law. Among these, he cites the bankruptcy of Houston-based Enron, which occurred when he was serving as attorney general of Texas. (Mind you, that case was filed in New York, not Delaware, so my state had no parochial interest in it.)

What the senator fails to note is that the judge presiding over the Enron case held a multiday evidentiary hearing to
consider the appropriate venue and then issued a lengthy written opinion. The court held that venue should remain in New York precisely because it was substantially more convenient for the vast majority of creditors who would actually need to be heard in the case. Enron's Official Committee of Unsecured Creditors, a statutory fiduciary charged with protecting the interests of all unsecured creditors, supported that result.

So the venue of the bankruptcy case was not harmful to those whom Enron hurt. The court specifically ruled that the case should remain in New York to help Enron's victims — and the victims agreed. It was Enron's management that hurt them, not its choice of a bankruptcy court.

Sen. Cornyn's attempts to link WorldCom's problems with its choice of bankruptcy court are similarly misplaced. The court overseeing the WorldCom restructuring imposed almost unprecedented restrictions on the company's operations. It appointed Richard Breeden, a former chairman of the Securities and Exchange Commission, as the corporate monitor of the company. And Breeden was involved at every step of the proceedings, expressing strong views on many facets of the restructuring. Again, it was the company that misbehaved, not the bankruptcy court.

A BETTER PLACE TO FILE

Sen. Cornyn's venue argument rests on yet another shaky foundation — the assertion that, to be fair to creditors, the location of a company's principal assets or corporate headquarters is a uniquely appropriate or convenient forum for the disposition of large Chapter 11 cases. In fact, courts handling large corporate bankruptcies have found that, while a headquarters building may be located in one jurisdiction, more often than not the locus of these cases and the majority of their creditors, especially those who most likely need to appear in court to protect their interests, are actually located elsewhere.

For example, WorldCom's headquarters was in tiny Clinton, Miss., one-time CEO Bernard Ebbers' hometown of fewer than 25,000 people. In Clinton, WorldCom had about 1,000 employees. By contrast, it had several times that number of employees in the Washington, D.C., area. For them and for the worldwide company's many creditors, New York (where the bankruptcy was filed) was surely a much more convenient location than Mississippi.

Sen. Cornyn repeatedly invokes the employees of bankrupt companies who, he contends, can't protect their interests in far-off courts. In fact, most employees are fully protected in bankruptcy law by so-called first day relief, which permits uninterrupted payment of employee claims against a bankrupt entity.

Most surprising in Sen. Cornyn's article is his assessment of the objectivity of bankruptcy judges. He refers to an "undeniable temptation" for judges to lean in favor of parties in ways that suit the judges' own personal interests. He declares that "picking the judge isn't far from picking the verdict."

While I hesitate to challenge Sen. Cornyn, a former justice of the Texas Supreme Court, in his view that judges are biased, I cannot agree. Objective studies have repeatedly demonstrated that large companies seeking to reorganize choose a bankruptcy court based on its efficiency and its judges' expertise, not a presumed point of view.

THE LOPUCKI ANALYSIS

To support his assertions, Sen. Cornyn turns to the writings of two academics, Harvard law professor Elizabeth Warren and UCLA law professor Lynn LoPucki. As to professor Warren, she is one of the most-prominent critics of bankruptcy reform. Sen. Cornyn, who supported the major bankruptcy legislation enacted in April, criticized Warren's arguments on the merits of that bill, yet when it serves the parochial interests of his state, he finds her arguments suddenly compelling.

But the real political momentum behind Sen. Cornyn's argument is the advocacy of professor LoPucki. He has made a career of attacking the bankruptcy venue rules, in a number of articles and now a book. LoPucki argues that the venue rules create a "race to the bottom" among bankruptcy courts seeking the business of reorganizing companies.

LoPucki's study has been repeatedly criticized by a number of important scholars. Vanderbilt law professors Robert Rasmussen and Randall Thomas analyzed LoPucki's methodology and concluded that it is significantly flawed and that his conclusions are not supported by the facts. One of the country's premier bankruptcy law practitioners, Harvey Miller, conducted a statistical study on the issue and concluded that LoPucki's claims are "the stuff of myths." A former director of the American Bankruptcy Institute, Thomas Salerno, wrote in the ABI Journal that LoPucki's conclusions are "unsupported and scurrilous."

And last October, professors Kenneth Ayotte of Columbia Business School and David Skeel Jr. of the University of Pennsylvania Law School published a study of venue choice in bankruptcy titled "Why Do Distressed Companies Choose Delaware? An Empirical Analysis of Venue Choice in Bankruptcy." Using a multivariable regression analysis, they concluded that LoPucki's study is faulty. Specifically, they found that there is no race to the bottom with
regard to bankruptcy venue.

To the contrary, Ayotte and Skeel found that "The Delaware court emerges as an important option for firms that stand to gain the most from its expertise in handling large bankruptcy cases." Indeed, according to their data, "Firms headquartered in states whose courts have less case expertise are the most likely to incur the costs of filing in Wilmington."

So there is no race to the bottom, bankruptcy courts do not abuse the venue rules, and companies choose a bankruptcy venue based on the expertise of the court in handling complex reorganizations, not in some sinister effort to game the system on their executives' behalf. Therefore, to upend long-standing venue rules would not help creditors or protect shareholders; it would undermine the workings of our bankruptcy court system. It would prevent companies with complex financial problems from filing in the bankruptcy courts best equipped to handle their cases and most convenient for all parties.

Congress should not repeat that mistake.

Joseph R. Biden Jr. is a Democratic senator from Delaware and a former chairman of the Senate Judiciary Committee.