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Courting Failure

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BOOK SUMMARY

Courting Failure

COURTING FAILURE: HOW COMPETITION FOR BIG CASES IS CORRUPTING THE BANKRUPTCY COURTS. By Lynn M. LoPucki. *Ann Arbor: University of Michigan Press*, 2005. Pp. xii, 322. $27.95 (cloth).

LYNN M. LOPUCKI†

Courting Failure[1] is the story of a bad venue statute that led to rampant forum shopping by large public companies. This forum shopping induced competition among bankruptcy courts for the cases. That competition in turn caused the unnecessary failure of many of the reorganizing companies and corrupted the United States Bankruptcy Courts. Congress has not acted to fix the statute because of Delaware's parochial interest in preserving the status quo.

INTRODUCTION

The *Courting Failure* story begins with enactment of the statute in 1978.[2] The statute established four separate

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1. LYNN M. LOPUCKI, COURTING FAILURE: HOW COMPETITION FOR BIG CASES IS CORRUPTING THE BANKRUPTCY COURTS (2005).

2. 28 U.S.C. § 1408 (2000).

bases for bankruptcy venue. A debtor could file at (1) its residence or domicile, (2) its headquarters, (3) the location of its principal assets, or (4) any place where an affiliate of the debtor was already in bankruptcy. In self-serving decisions, the competing bankruptcy courts held that a corporation's "residence or domicile" was at its place of incorporation.

Together, these four alternatives gave large public companies the right to file almost anywhere they chose. The first and fourth alternatives are the most problematic. The Enron case illustrates their use. Enron was a Houston-based company, incorporated in Oregon. Enron's top executives, including Kenneth Lay, Andrew Fastow, and Jeffrey Skilling, were all on the fiftieth floor of Enron's gleaming glass headquarters building in downtown Houston. Seven thousand five hundred other Enron employees worked in Houston. Enron's executives, however, chose to file Enron's bankruptcy in New York, where the company had only fifty-seven employees engaged in a small trading operation. The legal basis for that choice was that Enron Metals & Commodity Corporation, an Enron subsidiary, was incorporated in New York. The executives put the New York subsidiary into bankruptcy in New York, put Enron into bankruptcy in New York a few minutes later, and claimed proper venue on the ground that Enron's affiliate (the New York subsidiary) was already in bankruptcy there. The New York court, which was competing for cases like Enron, agreed.

When the new venue statute went into effect in 1979, companies began cautiously exercising their new right to choose. The rate of forum shopping—defined as filing in a court away from the company's headquarters—was about 20% in the early 1980s. In the middle of that decade, it increased to about 40% and plateaued. The rate rose to about 65% in the mid-1990s where it has remained since.

The drafters of these venue rules realized they were giving companies a broad choice of courts in which the companies could legally file. The drafters had no intent, however, to give debtors the right to pick the courts that would decide their cases. They gave broad choice only to make sure each company had the right to file in the most appropriate court. They reasoned that if a company chose a court other than the most appropriate, the chosen court would transfer the case to the most appropriate court. What

they failed to anticipate was that the bankruptcy courts would want the cases, compete for them, and refuse to transfer them.

Transfers of large public company cases are rare. *Courting Failure* observes that of the ninety largest cases filed in Delaware, the Delaware court transferred not a single one. The Enron case illustrates the extent of the no-transfer problem. Major creditors petitioned the New York bankruptcy court to transfer venue to Houston. The New York court ruled that the case should remain in New York "in the interests of justice and for the convenience of the parties."[3]

I observe in *Courting Failure* that:

> Not all judges do want the cases. Those who do, want them for any of four reasons. The most obvious are personal. A judge who presides over the reorganizations of large public companies has the opportunity to work with the leading professionals in the fields of bankruptcy and finance. When the judge does so, the judge is the most powerful person in the room. Millions and sometimes even billions of dollars turn on his or her decision. The status that power confers extends beyond the courtroom.
>
> Celebrity comes along with the power. The judges' decisions are reported in the media. Judges in the biggest cases have standing invitations from professional organizations to travel to resort cities at the organizations' expense to give speeches and be honored. If they return to law practice, which many do, clients with big cases will seek them out. When a bankruptcy judge dies, the obituary will likely mention the big cases over which the judge presided—assuming, of course, there were any.
>
> The most important reasons that the judges want the big cases, however, are more subtle. Each bankruptcy judge is a member of a community. In any large city in the United States, there are 100 or more lawyers and other professionals specializing in bankruptcy practice. Those professionals interact daily as they resolve cases in the local bankruptcy court. The professionals in a city typically form an association that meets regularly for lunch and occasionally for multi-day conferences. Many of the members become close friends.

3. 28 U.S.C. § 1412 (2000); *In re* Enron Corp., 274 B.R. 327, 347 (Bankr. S.D.N.Y. 2002).

> When a bankruptcy judgeship becomes available, the community seeks to install one of its own. More often than not, the effort succeeds. As with any position of leadership, the one chosen incurs a debt to his or her supporters. Those supporters expect a certain amount of loyalty. If a judge forgets how he or she got the job, the judge will be reminded if and when the judge seeks a second term. The committee that passes on reappointments will probably survey the members of the local bankruptcy bar regarding the quality of the judge's prior service. A recent study found that more than 8 percent of the bankruptcy judges who applied for reappointment during the period 1998 to 2002 were not reappointed. Others won reappointment but only after their competence had been challenged and they had been "put through the wringer."
>
> For bankruptcy professionals, bankruptcy venue is a bread-and-butter issue. If a big St. Louis company—such as TWA, Purina Mills, or Solutia—files in St. Louis, leading St. Louis bankruptcy lawyers are likely to get the key roles in the case and the big fees that come with them. If the case is big enough, virtually every bankruptcy lawyer in St. Louis will have a client. If instead the company files in some other city, bankruptcy lawyers in that city will get most of the work and the money. If most of the cases from a city go elsewhere, the career prospects in that city may be limited. And if the lawyers in a city view their judges as the cause of that problem, things can get ugly.
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> . . . .
>
> The process by which pressure to compete is brought to bear on the judges is brutal and intimidating. The lawyers who place cases are among the most powerful and prestigious of the bankruptcy bar. They publicly laud the judges who give them what they want and harshly criticize those who do not. Some of the latter become pariahs of the national bankruptcy bar—judges considered so bad they drive the cases away. Lawyers—and other judges—malign them as "toxic judges."[4]

NEW YORK

In the early 1980s, the New York bankruptcy court was the destination of choice for large public company bankruptcies. That court achieved about a 30% market share. Lawyers gave as their reasons for choosing New York

4. LOPUCKI, *supra* note 1, at 20-23.

the city's unique position as the financial center of the United States, the experience of the New York bankruptcy judges with big cases, and the willingness of the New York judges to give debtors lengthy delays and debtors' professionals big fees.

Although the four-to-five-judge New York court assigned cases by random draw, a single judge—Burton R. Lifland—ended up with more than half the cases. New York's reign as the bankruptcy capital of the United States came to an end in the late 1980s with a dispute over the randomness of the random draw. The void left by New York's disappearance did not last long.

DELAWARE

During the 1980s, the United States Bankruptcy Court for the District of Delaware was a sleepy backwater. During the entire decade, the Delaware court reorganized only one large public company. That company, Phoenix Steel, barely met the standard for "large" ($230 million in assets, measured in current dollars) and its choice of the Delaware court was probably just a convenience. Phoenix Steel's assets and operations were located in Delaware. In November of 1990, the Delaware court suddenly began attracting companies from out of state. The number of companies attracted grew steadily in a time when the number of large public company filings nationally was falling. By 1996, Delaware had achieved a near monopoly on large public company bankruptcy filings. That year, thirteen of the fifteen large public companies (87%) that filed anywhere in the United States filed in Delaware.

That it was Delaware rather than some other court that made this move was not coincidental. The Delaware legal community has a long history of competing to sell legal advantage to clients from outside the state.

> Despite its onshore location, the state of Delaware is a haven, engaged in many of the same businesses pursued by offshore havens such as Bermuda, the Cayman Islands, the Cook Islands, Gibraltar, the Jersey Islands, the Netherlands Antilles, and Mauritius. Havens are states or countries that turn lawmaking into a business and prey on their neighbors. Their lawmaking differs from that of other governments in that the laws havens make are not for their own citizens.

Haven laws are for foreign clients. Havens are law "exporters."[5]

As described in the prologue, Delaware got its start as a haven over a century ago, in the business of incorporation. Some 60 percent to 80 percent of all large public companies incorporated in the United States are incorporated in Delaware. "Incorporation" is, of course, a mere legal fiction. To incorporate in Delaware, the company need have no employees, assets, offices, or operation there. All a company need do to gain the benefits of Delaware incorporation is send documents and money to Delaware's public officials. The main benefit of Delaware incorporation is freedom from restriction by the corporate laws of other states and countries. The "internal affairs" of a corporation are governed by the law of the state or country of incorporation. For a Delaware corporation, that means Delaware law, regardless of where in the world the corporation actually does business.[6]

Delaware is also in the usury-facilitation business. That is, Delaware provides a haven for credit card issuers, who charge residents of other states interest rates prohibited by the laws of those other states.[7]

Seeking to build on its success in attracting incorporations, Delaware has recently engaged in efforts to sell corporations on the idea of litigating in Delaware. Among those efforts was the mailing of a glossy brochure touting a survey commissioned by the United States Chamber of Commerce. In that survey, in-house lawyers for large public companies ranked the Delaware state courts first in the nation on each of ten criteria. The survey shows corporations clearly satisfied with their treatment in the Delaware courts. The survey's criteria included "punitive damages" and "timeliness of summary judgment/dismissal"—two issues dear to the virtual hearts of American corporations.

By 1990, Delaware was already well established in the business of selling law, legal status, and litigation to the rest of the United States. Delaware's expansion into the bankruptcy reorganization of large public companies was a logical next step. Delaware already had the confidence of the

5. *Id.* at 51.

6. *Id.* at 53.

7. *Id.*

large public companies that were filing for bankruptcy. Seventy-three percent of the large public companies that have filed bankruptcy in the United States since 1992 were incorporated in Delaware.[8]

THE FEDERAL GOVERNMENT STRIKES BACK

The sudden shift of big-case forum shopping to Delaware surprised and alarmed bankruptcy lawyers and judges in the rest of the United States. The shift cost non-Delaware lawyers millions of dollars in fees. Bankruptcy judges throughout the United States were concerned about the loss of their biggest cases and the overall appearance of impropriety.

Scandal stuck at the end of 1996 and the beginning of 1997. First, the National Bankruptcy Review Commission recommended that Congress eliminate venue based on incorporation or the pendency of an affiliate's case. Second, a report on bankruptcy forum shopping prepared by the Federal Judicial Center for the Judicial Conference of the United States reported that the chief judge of the Delaware bankruptcy court routinely had ex parte contacts with the lawyers for large public companies that had not yet filed cases. Just seventeen days after release of the Federal Judicial Center report, the chief judge of the Delaware district court revoked the reference of Chapter 11 cases to the bankruptcy court. The district court essentially took over the bankruptcy court's big-case docket.

Delaware hung on and the sense of outrage over Delaware's grab for the big-case bankruptcies did not last. By the end of 1998, the scandal had blown over. It was clear that Congress would take no action on bankruptcy venue. The bankruptcy courts accepted the reality of competition. If they wanted big cases, the courts would have to fight for them.

FAILURE

The consequences of court competition for reorganizing companies did not become clear until 2000. That year, Sara D. Kalin and I discovered that companies reorganized in Delaware and New York during the period of the Delaware

8. *Id.* at 55-56.

court's ascendancy refailed at rates two to ten times as high as the rates for companies incorporated in other courts. The extent of the debacle is captured in Table 6 of *Courting Failure.*[9]

Table 6. Failure Rates by Court, Large Public Companies Emerging 1991–96

	Delaware	New York	Other courts
Refilings	11 (42%)	3 (19%)	2 (4%)
Business failures	6 (24%)	4 (25%)	7 (13%)
Reorganization failures	14 (54%)	5 (31%)	8 (14%)
Earnings	–9%	–3%	1%
Number of cases for this court	26	16	56

The table shows that large public companies that reorganized in Delaware and emerged as public companies were more than ten times as likely to refile bankruptcy within five years (a 42% refiling rate for Delaware, as compared with a 4% rate for courts other than Delaware and New York).[10] One aspect of the mechanism by which Delaware-reorganized companies failed is also apparent from the table. Companies emerging from reorganization in courts other than Delaware and New York had average earnings of 1% per year during the five year period after bankruptcy. Companies emerging from Delaware reorganization had average losses of 9% per year. Companies were flocking to the courts least likely to reorganize them successfully.

THE COMPETITION GOES NATIONAL

During the late 1990s, the bankruptcy community remained unaware of the Delaware and New York courts' high refailure rates. Lawyers, judges, and reorganizing

9. *Id.* at 113.

10. Later shifts in the data increased the Other Courts' refiling rate from 4% to 6%. Lynn M. LoPucki, Bankruptcy Research Database (2005), *available at* http://lopucki.law.ucla.edu.

companies supposed that "the market's" preference for Delaware and New York reorganization indicated that those courts were doing the best, not the worst, job of reorganizing companies. Big-case bankruptcy was booming, and Delaware and New York were getting the lion's share of the business. More than forty large public companies a year were filing in Delaware at the peak. One effect of Delaware's success was to spur competitive efforts by bankruptcy courts in nearly all major cities. The fact that the courts were competing for their cases put the case placers in the driver's seat. They could play courts off against one another, and in the long run, get pretty much whatever they wanted.

> Delaware's new bankruptcy industry came at the expense of bankruptcy lawyers practicing in major cities throughout the rest of the country. Those lawyers began pressing their local bankruptcy judges to respond to Delaware's competitive threat. Courts in several major cities modified their local rules and practices to compete for large public company bankruptcies.
>
> This response to Delaware was possibly unprecedented. In other circumstances, courts have sometimes expressed views or made rulings that attracted cases. In the 1980s, for example, the liberal Texas state courts attracted the cases of workers injured on North Sea Oil rigs. In the early 1990s, U.S. district judge Jack Weinstein attracted gun and tobacco plaintiffs from all over the United States to his court in Brooklyn. But those were merely situations in which judges expressed views that attracted cases. Judges were not changing their views in order to compete with other courts for cases.
>
> Some of the changes that resulted from the bankruptcy court competition were for the better. Judges who had thought of themselves as emperors presiding over federally allotted domains suddenly found that they had to treat lawyers and litigants with courtesy and respect. If the judges didn't, the "customers" would go elsewhere. The judges became more responsive and accessible. They scheduled hearings for the convenience of the lawyers and litigants, not merely for their own. They published rules and guidelines explaining what they wanted from the lawyers, and they committed to what they would do in response. One effect was to make the bankruptcy reorganization process more predictable, generally to the benefit of everyone involved.
>
> The pressures of competition did not, however, stop at the boundaries of propriety. The lawyers, corporate executives,

> banks, and investment bankers who chose the courts for their cases—the "case placers"—had the power to make winners or losers of the courts. The case placers wanted more money for themselves and freedom from the restrictions of bankruptcy law and procedure. In cities across the United States, they pressed the judges to see how much each judge was willing to give them.
>
> Slowly but surely, the entire bankruptcy system began shifting in response to the case placers' wishes. Professional fees, which had fallen sharply since the 1980s, began to increase. The courts relaxed conflict of interest standards and granted lawyers and financial advisers unprecedented releases and indemnification from liability for their own wrongdoing. The jobs of executives—including those who led their companies into financial disaster—became more secure, and the courts allowed their companies to pay their executives huge bonuses, supposedly to retain the failed executives' valuable services. Deals made among the case placers were sacrosanct, even if they violated the rights of other parties. Procedures designed to protect small investors and the public were abandoned.[11]

The case placers had, in essence, taken control of the United States bankruptcy courts.

CORRUPTION

What made *Courting Failure* controversial was its allegation of "corruption" in the United States bankruptcy courts. Here is the passage in which that word is defined:

> To understand how competition is corrupting the U.S. bankruptcy courts, begin by distinguishing court competition from mere forum shopping. Courts inevitably differ in ways that advantage one litigant over another. A court may interpret a law differently or favor a particular kind of litigant or case. One court may process cases faster than others or be geographically more convenient. For centuries, lawyers have maneuvered their cases into the courts most advantageous to themselves or their clients. Forum shopping can yield benefits to shoppers without courts changing what they are doing—or even realizing that the shopping is occurring.
>
> By contrast, court competition is an active, deliberate response by the court to forum shopping. When courts

11. LOPUCKI, *supra* note 1, at 17-18.

> compete, they change what they are doing to make themselves more attractive to forum shoppers. If more than one court competes, the process becomes reiterative. Court A offers to do X for shoppers; court B offers to do X plus Y. Court C—or court A—can then offer to do even more. The court that offers forum shoppers the most may be the only one that gets cases in the end, but all of the judges who compete are corrupted along the way. Their actions are "corrupt" in that they are dictated not by an attempt to apply the law to the facts of the case but by the need to remain competitive.[12]

"Corruption," as defined here, means ruling on cases in a manner that the ruling judge knows to be improper. *Courting Failure* contains no allegation of corruption against any particular court or judge. The reason is that I had no basis for knowing what any particular judge was thinking at the time of any particular ruling. What nevertheless made it clear that competition was corrupting the bankruptcy courts was the pattern of change in the system as a whole.

> Bankruptcy court competition brought quick, fundamental change to the bankruptcy system. Without policy debate or legislation, cases got faster, compensation for professionals and managers increased, and laws and procedures designed to protect small stakeholders were increasingly ignored. The movements in these directions have not been relentless. Sometimes they proceeded by fits and starts. Embarrassed by public criticism, courts sometimes took steps to rein in the most egregious of their practices. Some waver so much it is difficult to say whether they are even in the competition. But once a new practice that benefits case placers is introduced, competition assures its acceptance. The only way for the system to reject the new practice is for every court to reject it. If even a single court breaks ranks, that court tends to get the cases, and the practice becomes dominant.

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12. *Id.* at 137.

The most damaging changes competition brought were these.

1. The courts lost control over professional fees.
2. Failed managers tightened their grips on their jobs and companies.
3. Corporate debtors had more difficulty recovering money taken by failed managers.
4. Failed managers began paying themselves huge retention bonuses.
5. The courts began rubber-stamping prepackaged plans.
6. So-called critical vendors began grabbing the shares of other unsecured creditors.
7. Managers began selling their companies at inadequate prices for personal benefit instead of reorganizing them.

In each of these respects, practices changed quickly throughout the United States. In each, the change occurred after 1990, the year in which Delaware initiated the competition. In none were the changes prompted by legislation, judicial decision, or policy debate. In all, the direction of change favored the case placers.[13]

Any particular judge could have reached the conclusion that the case placers should win on any particular issue—and perhaps even that the case placers should win on every issue in every case. But it is beyond plausibility that so many judges—on these issues and on every other major trend in big-case bankruptcy—concluded that the expedient (competitive) thing to do just happened to be the right thing to do.

THE COMPETITION GOES GLOBAL

Courting Failure contains two chapters on the critical changes now taking place with respect to international competition for big cases. Under the old, "territorial" system, companies could, and did, file in whatever countries they chose—regardless of the locations of their assets and operations. That caused few problems, however, because the courts' decisions had no effect in other countries beyond what those other countries chose to grant them. Under the

13. *Id.* at 139-40.

new "universalist" system now being implemented, companies will be required to file in their "home" countries. The home country court will administer the case worldwide according to home country law. Countries other than the home country commit in advance to give effect to the home countries' decisions.

The problem with the new universalist system is that large public companies don't actually have "home" countries. Universalism will give the case placers not only their choice of courts, but their choice of bankruptcy laws. Few mechanisms exist to address the problems that result from international venue abuses. In the European Union, where a universalist system has been in place since 2002, forum shopping and court competition quickly became rampant.

CONCLUSION

Courting Failure correctly predicted that Congress would award Delaware four additional bankruptcy judgeships in 2005, and speculated on the consequences.

> Two scenarios then seem plausible. In the first, Delaware's market share again climbs to near 90 percent. This time it remains there. In three or four years, the shift becomes irreversible. The skills and experience necessary to process big bankruptcy cases have grown in Delaware and disappeared from the rest of the United States. Many of the top professionals working in the bankruptcy field have moved to Delaware. Others have been replaced by ambitious young bankruptcy professionals already in Delaware. The bankruptcy courtroom construction begun in Delaware in 2003 has been completed and yet more courtroom construction begun. The bankruptcy court competition ends with Delaware's victory—just as the corporate charter competition did around 1920.
>
> In the second plausible scenario, the New York bankruptcy court fights back. The New York court's location in lower Manhattan—convenient to the world's leading bankruptcy professionals and numerous corporate headquarters—provides a powerful advantage. Few leading bankruptcy professionals would prefer to live and work in Delaware, and so they make an effort to keep as many cases as possible in New York. (Living in New York while doing the cases in Delaware is a possibility, but contrary to the glib assertions sometimes made, it takes substantially longer for a New York professional to travel to Penn Station,

take the Metroliner 125 miles to Delaware, and then walk eight blocks to the Wilmington courthouse than it does to travel to the New York court in lower Manhattan.) Despite the New York professionals' work site preference, the New York court would not win the competition. The New York professionals would keep the Delaware court alive as a check on the New York court. With the two courts in competition, the case placers could play them off against one another to increase the case placers' power over both. In this scenario, the New York professionals would reward the New York court for "good" behavior by doling out cases to the court in much the same way that a biologist doles out kernels of corn when training a chicken to do a pirouette. Eventually, both courts might be dancing to the case placers' tune—pretty much without regard to bankruptcy law.[14]

What will the courts offer the case placers in return for their favor? *Courting Failure* predicts that when the gloves come off, the competing courts will (1) dispense with the random draw so each can offer large public companies their "best"—meaning most competitive—judges, (2) cease trying to impose any limitations at all on the case placers, and (3) try instead to craft rulings that will enable the case placers to externalize costs to third parties.

The initial round of court competition is only now coming to a close. In that round, the courts focused principally on procedural matters such as establishing omnibus hearings, assuring quick action on first-day motions, and paying professionals monthly. The courts interested in competing have already made these changes. The case placers no longer shop for these practices; they can find them in almost any big city court. Courts interested in improving their market shares now must offer something more.

The most attractive procedural change an ambitious court could offer would be to abandon the random draw as the primary method of assigning big reorganization cases to judges. The random draw is a powerful tradition in state and federal courts. It guards against corruption by making it impossible for case placers to choose particular judges. The random draw also promotes harmony among the judges of a panel by protecting each against discrimination in case assignments.

To the case placers, however, the random draw is anathema. The case placers want predictability. That is,

14. *Id.* at 246-47.

they want to know what the judge will do with their case before they irrevocably surrender it by filing. The best way to know what the judge will do is to know who the judge will be. Recall from chapter 3 that when the Delaware bankruptcy court went from one judge to two, it began telling debtors which judge they would get before the debtors filed. Under a random draw, one toxic judge on a panel of five or ten is usually enough to drive cases away.

No law requires the bankruptcy courts to assign cases by random draw. The chief judge of a panel can assign them in whatever manner the judge chooses. Competitive pressures have already begun to erode the practice of random assignment. Both the Houston and Chicago bankruptcy courts have established separate draws for "complex cases." Judges of those two courts are excluded from the complex case draws only if they so request. In Houston, one has. But if the court competition continues, it is only a matter of time before courts seize the competitive advantage that would come from involuntarily eliminating their least attractive judges from the draws. When that occurs, it will signal that the bankruptcy court competition has entered its final, desperate stages. Not only will the case placers be in a position to play off courts against other courts, they will be in a position to play off judges of a court against other judges of the same court.

If Congress allows the bankruptcy court competition to continue, the substantive changes already visible in the competing courts' practices will accelerate. To the extent that the courts have placed any limits on incumbent managers' pay, authority, or job security, the courts will remove them. The same will be true of limits on pay, conflict-of-interest restrictions, or liability releases of bankruptcy lawyers and investment bankers. The courts will facilitate sales of companies that enable managers and their new investors to make a quick profit by externalizing costs to employees, the Pension Benefit Guarantee Corporation, local governments, and customers who already own the firms' products. The bankruptcy courts will actively seek new ways in which they can protect the case placers from investigations by criminal prosecutors, the Securities and Exchange Commission, other regulatory agencies, class action lawyers, and anyone else who threatens them.[15]

Courting Failure offers two alternative proposals for reform. The first is to require companies to file in their local

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15. *Id.* at 249-50.

bankruptcy courts. The second is to establish regional courts that would specialize in big-case reorganizations.

> First, Congress could adopt venue rules similar to those proposed by the National Bankruptcy Review Commission in 1997. The new rules should delete the debtor's place of incorporation from the list of proper venues and provide for the mandatory transfer of misfiled cases to the proper venue. With few exceptions, Delaware would no longer be a proper venue.
>
> These new rules should also eliminate the venue hook—the ability of a parent company to file in the court where the bankruptcy of a subsidiary is pending. Members of a corporate group should be allowed to reorganize together only at the location of the parent company or the group.
>
> These changes would effectively require a company to file its bankruptcy at the location of the company's headquarters or principal assets. Companies with headquarters and principal assets in different districts would still be able to choose between the two districts. Companies would also remain free to move their headquarters or principal assets to the district in which they chose to file. That means some shopping could continue, enabling companies to escape particularly bad courts. But such shoppers would not exist in sufficient numbers to corrupt courts that hoped to attract them.
>
> One problem with requiring companies to file in their local bankruptcy courts is that few of those local courts would have much expertise in the reorganization of large public companies. To put the same point another way, the big-case expertise of the American bankruptcy courts would be spread among so many judges that few or none could develop substantial expertise.
>
> As an alternative to the rules just discussed, Congress might establish specialized bankruptcy courts at three or four locations in the United States to handle only the largest cases. Each of the specialized courts would serve a specified territory. Companies over a specified size would all file their bankruptcy cases with a single judge. Working from information required to be filed with the petition, that judge would assign each case to the most appropriate of the four courts based on geographical considerations. The assignment would be made on the same day the company filed the case.[16]

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16. *Id.* at 252-53.

UPDATE

Courting Failure was published at the end of January, 2005. The following month, the Senate Judiciary Committee began considering the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA).[17] Senator John Cornyn (R-Tex), who had, as attorney general of the State of Texas, represented the creditors who petitioned unsuccessfully for a change of venue in the Enron case, took up the cause of bankruptcy venue reform. Senator Cornyn introduced the Fairness in Bankruptcy Litigation Act of 2005.[18] The bill would require that companies file in their local bankruptcy courts, echoing both the recommendations of the National Bankruptcy Review Commission and the first of my alternative proposals described above. During committee debate, Senator Cornyn had a copy of *Courting Failure* on his desk and, at one juncture during his speech, held it aloft to make a point. Senator Cornyn declared his intention to move to amend the BAPCPA to add the provisions of his venue bill. Fearful that the venue amendment would break up the bipartisan coalition supporting the BAPCPA, the Republican leadership prevailed upon Cornyn not to make his motion. He did not make the motion, but his venue bill remains pending in the Senate.

Congress enacted the BAPCPA in May 2005 and it went into effect on October 17 of that year. The Third Circuit then began the process of selecting Delaware's four new bankruptcy judges. Of the four candidates chosen, three were Delaware bankruptcy lawyers and the fourth was a Philadelphia bankruptcy judge who recently had been serving as a visiting bankruptcy judge in Delaware. As the new judges took office in the spring of 2006, big-case bankruptcy filings were at only one-fourth the level they were when congressional leaders decided Delaware needed four new judges and the biggest bankrupt companies were uniformly choosing New York over Delaware. Thus, the new Delaware judges' work is cut out for them. If they want the big cases, they are going to have to fight for them.

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17. Pub. L. No. 109-8, 119 Stat. 23 (2005).

18. S. 314, 109th Cong. (2005).