COMMERCIAL LAW LEAGUE OF AMERICA
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CLLA HILL DAY

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BANKRUPTCY VENUE REFORM ACT

1. PROPOSAL

On February 14, 2023, Representatives Lofgren (D-CA) and Buck (R-CO) introduced the Bankruptcy Venue Reform Act (H.R. 1017). Reintroduction of a companion bankruptcy venue reform bill in the Senate, based on S. 2827 from the 117th Congress is expected soon. S. 2827 was introduced by Senators Cornyn (R-TX) and Warren (D-MA) in September of 2021. These bipartisan bills required Chapter 11 cases to stay local by requiring corporate debtors to file where they have their principal assets or principal place of business. If passed and enacted, companies will have to file bankruptcy where they conduct their business. Debtors will no longer be able to unilaterally choose the jurisdiction or the judge they deem friendly. Instead, competent bankruptcy judges assigned randomly would oversee the reorganization of companies that are based in their own communities. A copy of the HR 1017 (118th Congress) and S. 2827 (117th Congress) can be found at:

https://www.congress.gov/bill/118th-congress/house-bill/1017
https://www.congress.gov/117/bills/s2827/BILLS-117s2827is.pdf

2. THE PROBLEM

Since 2004, it is believed that over 1,200 cases have fled to remote forums from their home state. A loophole in 28 U.S.C. §1408 allows companies filing chapter 11 to flee their home states and file bankruptcy in remote jurisdictions, and in some cases, before judges they handpicked. For example, in 2020, three bankruptcy judges, out of a total of 375 judges nationwide, heard 57% of all large commercial cases.[1] The financial and human toll is compelling. *Purdue Pharma, Johnson & Johnson* and *Boy Scouts* manipulated lenient venue rules to file in their courts of choice to stack the deck against their creditor victims. The ability of debtors and their professionals to manipulate laws and choose their own venue to achieve a desired outcome directly threatens the integrity of the bankruptcy system and erodes public confidence. Forum shopping by corporate debtors to obtain desired results has become so prevalent that United States District Court judges are taking notice and openly questioning the integrity of the bankruptcy system.[2]

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[1] Oversight of the Bankruptcy Code, Part I: Confronting Abuses of the Chapter 11 System: Hearings before the Subcommittee on Antitrust, Commercial, and Administrative Law, of the House Judiciary Committee, I 17th Cong. (2021) (written testimony of Adam Levitin): https://docs.house.gov/meetings/JU/JU05/20210728/113996/HHRG-117-JU05-Wstate-LevitinA-20210728.pdf. Similarly, a 2015 study by the Government Accountability Office, between 20 10 and 2014 found that 71% of large companies (assets and liabilities of $50 million or more) filed for bankruptcy in two Districts.

[2] Memorandum Opinion of US District Court, *Patterson v. Mahwah Bergen Retail Group* (In re Retail Group, Inc.), 2022 WL 135398 (E.D. Va. Jan. 13, 2022). (Court observed that 91% of large

The National Association of Attorneys General (NAAG) recognized problems in the current bankruptcy venue laws and in November 2021, issued a comprehensive letter signed by 43 Attorneys General endorsing support for HR 4193 (the predecessor bill to the current HR 1017) and S 2827.[3] That letter raised serious concerns about corporate debtors increasingly exploiting the generous venue provisions in the Bankruptcy Code, resulting in "unnatural" venue selections in courts with zero connection to the bankrupt companies, and limiting the development of bankruptcy jurisprudence and the adjudication of billions of dollars of liabilities to a handful of judges. The AGs, who are specifically charged with protecting their states' and citizens' legal and financial interests, enforcing consumer protection laws, and protecting the environment from contamination, warned that the rampant forum shopping of bankruptcy cases to distant venues chosen by the debtors is tainting the integrity of the bankruptcy system and breeding widespread distrust of the system.

3. THE IMPACT OF FORUM AND JUDGE SHOPPING

On February 8, 2022 the Senate Judiciary's Subcommittee on Federal Courts, Oversight, Agency Action and Federal Rights held a hearing entitled "*Abusing* Chapter *11: Corporate Efforts to Side-Step Accountability through Bankruptcy"*.[4] The hearing focused on the use of a divisive merger or "Texas Two-Step" to separate the talc tort claims against *Johnson & Johnson* into a new corporation (*LTL Management*) and then try to use bankruptcy to limit victim claims to the new entity. Members of the Committee observed that the then pending venue reform bills (HR 4193 and S 2827) could provide solutions to these attempts to manipulate the bankruptcy system by allowing courts to consider the propriety of this new tactic instead of judges chosen by the debtors themselves. On January 30, 2023, the Third Circuit dismissed the LTL bankruptcy citing LTL's effort to "manufacture venue" finding that LTL's petition has no valid bankruptcy purpose.[5]

A. Purdue Pharma

In a recent development, on May 30, 2023 the United States Court of Appeals for the Second Circuit ruled that a Chapter 11 reorganization plan may include nonconsensual third-party releases of direct claims against non-debtors widening the circuit split on this controversial issue. In so holding, the Court of Appeals reversed a decision of the United States District Court for the Southern District of New York which had declared that such releases were not statutorily

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chapter 11 cases filed in only four Districts and in reversing the bankruptcy court's confirmation of a plan with broad third-party releases, judge remanded the matter to a different bankruptcy court and not the one chosen by the debtors)

[3] *See,* a copy of the NAAG letter at https://www.naag.org/policy-letter/naag-endorses-bankruptcy-venue-reform-act-of-2021/

[4] *See*, https://www.judiciary.senate.gov/meetings/abusing-chapter-11-corporate-efforts-to -side-step-accountability-through-bankruptcy/

[5] LTL Opinion footnote 19 found on page 54 of the 3rd Circuit Opinion.

authorized, and had overruled the Bankruptcy Court's confirmation a reorganization plan with the releases. The Second Circuit reasoned that several sections of the Bankruptcy Code supported the jurisdiction and authority of the bankruptcy court to approve third party releases of the personal liabilities of directors, officers, shareholders of the Debtor who owned the privately held company for their role in improperly marketing and selling opioids. The corporate Debtor and their owners had faced thousands of lawsuits by individual victims of opioids and many states of the United States but only the corporation, not the owner family members had filed for bankruptcy; the plan of the Debtor released the family member owners from all liabilities in connection with the Debtor's debts in exchange for a voluntary contribution of approximately $6 billion; and the family members owners retained over $11 billion in distributions from the Debtor. *In re Purdue Pharma L.P.*, 69 F.4th 45 (2nd Cir. 2023).

The Circuits are starkly divided on this important issue. The Fifth, Ninth and Tenth Circuits have held that permanent injunctions that effectively discharge the debts of nondebtors are beyond the power of the bankruptcy courts. Whereas the Fourth, Sixth, Third, Seventh and now again, the Second Circuit are less strict and allow for the possibility of nonconsensual third-party releases in a confirmed Chapter 11 plan of reorganization. See, *First Energy Sols. Corp.*, 606 B.R. 720, 733-734 (Bankr. N.D. Ohio 2019). The result of the Second Circuit's decision in *Purdue Pharma*, will likely encourage more forum shopping to the courts that allow for nonconsensual releases, and further undermining public confidence in the bankruptcy system via venue manipulation, accelerating the disenfranchisement of creditors, employees and other parties and impairing the development of bankruptcy jurisprudence by concentrating cases into these districts.

Seeing the continuing degradation and threat to the bankruptcy system, on July 7, 2023 the Solicitor General filed a petition for certiorari asking the US Supreme Court to review the Second Circuit's decision in *Purdue Pharma*. Certiorari was granted and the case has been fully briefed, argued and awaiting the US Supreme Court's decision. *William K. Harrington vs. Purdue Pharma L.P. et al.,* U.S. Supreme Court, No. 23-124 (2023). The Commercial Law League and the Venue Group filed an filed an amicus curiae brief arguing how the split in the circuits help fuel forum shopping, especially in the bankruptcy courts.[6]

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B. Houston Bankruptcy Court Disaster

Another recent and concerning occurrence arises when there are limited judges in a district to handle complex commercial Chapter 11 cases, allowing practitioners to select specific judges for their case -- aka judge shopping. This was made evident in the Houston Bankruptcy Court, resulting in one of the biggest bankruptcy court scandals in US history, embroiling one of the top bankruptcy jurists who has overseen many of the significant Chapter 11 cases over the past ten years. As further explained in the misconduct complaint filed on October 13, 2023 by Priscella Richman, Chief Judge of the Fifth Circuit of Appeal against U.S. Bankruptcy Judge David R. Jones, Southern District of Texas:

[6]To download a copy of the CLLA amicus brief, go to https://clla.org/venue-reform-workroom/

"*Pursuant to Rule 5 in Article III of the Rules for Judicial-Conduct and Judicial-Disability Proceedings, I am identifying a Complaint against United States Bankruptcy Judge David R. Jones of the Southern District of Texas. Rule 5 provides that when a chief judge has information constituting reasonable grounds for inquiry into whether a covered judge has engaged in misconduct, the chief judge may conduct an inquiry, as he or she deems appropriate, into the accuracy of the information. I have conducted an inquiry and find there is probable cause to believe that misconduct by Judge Jones has occurred. It does not appear that an informal resolution is feasible at this time. I am therefore entering this written order stating the reasons for identifying a complaint.*

Judge Jones is in an intimate relationship with Elizabeth Freeman. It appears that they have cohabited (living in the same house or home) since approximately 2017. Elizabeth Freeman worked in Judge Jones's chambers as a law clerk. Subsequently, she was a partner in the Jackson Walker LLP law firm, it appears from at least 2017 until December 2022. She formed The Law Office of Liz Freeman, from which she has practiced since approximately December 2022.

Members of the Jackson Walker LLP firm have regularly appeared before Judge Jones since 2017. Judge Jones has approved attorneys' fees payable to that firm in which supporting documentation, that was submitted to Judge Jones and is part of public records, reflects that services by Elizabeth Freeman were performed in connection with a number of cases for which fees were sought and approved, though Elizabeth Freeman was not shown as counsel of record on the face of pleadings. The amounts billed for Elizabeth Freeman's services in those cases were substantial. The fees approved by Judge Jones for Jackson Walker LLP were likewise substantial. Judge Jones approved fees payable to Jackson Walker LLP in other cases in which Elizabeth Freeman does not appear to have provided any legal services or advice. However, at all times when Elizabeth Freeman was a Jackson Walker LLP partner, and regardless of whether she provided services or advice in a case, there is a reasonable probability that Elizabeth Freeman, as a partner in that firm, obtained a financial benefit from, or had a financial interest in, fees approved by Judge Jones. Judge Jones did not recuse in Jackson Walker LLP cases nor did he disclose his relationship with Elizabeth Freeman to the parties or their counsel in which Jackson Walker LLP appeared before him.

A motion to recuse Judge Jones was filed in a case in which Jackson Walker LLP was counsel of record. The basis of the motion was an allegation that Judge Jones was involved in a romantic relationship with Elizabeth Freeman. Judge Jones referred the motion to recuse to another bankruptcy judge but did not disclose to that judge the facts regarding his relationship with Ms. Freeman. On information and belief, the judge who ruled on the motion to recuse was unaware that Judge Jones was romantically involved with Ms. Freeman or that they were cohabiting. The motion to recuse was denied and appealed to a federal district court judge, and on information and belief, Judge Jones did not apprise that district court judge of the relationship with Ms. Freeman, and that judge was also

unaware of the facts regarding the relationship. The appeal was denied. There is a reasonable probability that if Judge Jones had disclosed the facts concerning his relationship with Elizabeth Freeman to his fellow bankruptcy judge, to whom the motion to recuse was referred, the motion to recuse would have been granted. Because the motion was denied, and Judge Jones did not voluntarily recuse, Judge Jones presided in the case and approved Jackson Walker LLP's attorneys' fees. Court records appear to reflect that those fees included amounts for services Elizabeth Freeman performed in connection with the case.

It appears that Judge Jones accepted an appointment from another bankruptcy judge to act as mediator in a matter in which Ms. Freeman, as a shareholder or partner in The Law Offices of Liz Freeman, was attorney of record for a party and participated in the mediation; that Judge Jones did not disclose his relationship with Ms. Freeman to the parties, to their counsel or to the bankruptcy judge who appointed Judge Jones. Judge Jones conducted the mediation to a conclusion.

In another matter over which Judge Jones presided, it appears that Judge Jones approved a fee application submitted by The Law Offices of Liz Freeman. It does not appear that any party or any other counsel in that proceeding was apprised of Judge Jones' relationship with Ms. Freeman.

It further appears that Judge Jones recommended to other judges in the Southern District of Texas that Ms. Freeman be appointed to the Lawyer Admissions Committee for the Southern District of Texas Bankruptcy Court. Judge Jones did not disclose his relationship with Ms. Freeman to those considering the appointment.

Judge Jones and Elizabeth Freeman are not married to one another, to the best of my knowledge, and do not hold themselves out as spouses. However, the Commentary to Canon 3C of the Code of Conduct for United State Judges provides " [r]ecusal considerations applicable to a judge's spouse should also be considered with respect to a person other than a spouse with whom the judge maintains both a household and an intimate relationship." In this regard, see also Guide to Judiciary Policy, vol. 2, sec. 220, Advisory Opinion 58; Potashnick v. Port City Construction Co., 609 F.2d 1101, 1112-14 (5th Cir. 1980).

Based on the foregoing, there is probable cause to believe that Judge Jones has engaged in misconduct, as that term is defined or described in the code of conduct applicable to federal judges including bankruptcy judges…" [7]

[7] A copy of the Fifth Circuit's Misconduct Complaint is available on PACER, U.S. District Court, Southern District of Texas attached as an exhibit to a civil case pending as *Van Deelen vs. Jones*, No. 4:23-cv-3729 located at https://ecf.txsd.uscourts.gov/cgi-bin/iquery.pl?125471125881855-L_1_0-1

4. THE SOLUTION

For the reasons stated above, the Commercial Law League and The Venue Group, a national ad hoc group of bankruptcy judges, lawyers and professionals support bankruptcy venue reform and the passage of H.R. 1017, along with an expected Senate companion bill (like S. 2827 that was introduced in the prior Congress). Venue reform has also been supported by the National Association of Attorneys General, United Mine Workers of America, National Association of Credit Managers, Iowa Bankers Association, Texas Hotel & Lodging Association, 163 sitting and retired bankruptcy judges, law professors from around the country, and dozens of state and local bar associations. And continues to grow as this problem continues to be left unsolved.

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For further information, please contact:
Peter C. Califano, Esq., (415) 882-5300 or pcalifano@nvlawllp.com