

Reprinted with permission from the 7/13/11 issue of *The Delaware Business Court*. (c) 2011 ALM Media Properties, LLC. Further duplication without permission is prohibited.

## Bankruptcy Court Rejects Challenge to Personal Jurisdiction in Preference Case

Barry M. Klayman and Mark E. Felger

*Special to the Delaware Business Court*

*Insider* | July 13, 2011

In a June 22 decision in a case of first impression, the Delaware Bankruptcy Court turned back a due process challenge to the exercise of the court's personal jurisdiction over a preference defendant. In *In re DBSI Inc.*, the trustee sought to avoid and recover pre-petition transfers made to various insiders and pre-petition transfers made on behalf of the insiders to the IRS and other taxing authorities. Thomas Var Reeve, one of the defendants, moved to dismiss the complaint for lack of personal jurisdiction. Reeve argued that he was a resident of Idaho who had insufficient contacts with Delaware, and even though Rule 7004(d) of the Federal Rules of Bankruptcy Procedure provides for nationwide service of process, the Fifth Amendment's Due Process Clause prohibited the court from exercising jurisdiction over him.

The trustee made three arguments in opposition to the motion: first, the court's retention of jurisdiction in the confirmed plan of liquidation precluded Reeve's arguments; second, the Fifth Amendment does not restrict the reach of Rule 7004's nationwide service of process; and third, even if the Fifth Amendment requires the court to consider "traditional notions of fair play and substantial justice," Reeve had sufficient contacts with Delaware because he did not show that litigating the case in Delaware would impose a severe burden on him. The court easily rejected the trustee's first argument, noting that the court's retention of jurisdiction in the confirmed plan of liquidation concerned jurisdiction over cases (subject matter jurisdiction) and not over parties to those cases (personal jurisdiction). The court then rejected the trustee's argument based on the "pure national contacts" approach to personal jurisdiction. That theory holds that if a federal statute authorizes nationwide service of process and the defendant has sufficient contacts with the United States, the inquiry is finished. In essence, every federal district court in the country has personal jurisdiction over that defendant. In rejecting this approach, the court noted that the 3rd U.S. Circuit Court of Appeals, in its 2002 opinion in *Pinker v. Roche Holdings Ltd.*, "assumed, without deciding, that service of process must comport with 'traditional notions of fair play and substantial justice.'" Thus, the court, consistent with *Pinker*, applied the Fifth Amendment Due Process Clause's fair play and substantial justice restrictions on nationwide service of process.

In the end, the bankruptcy court applied a twofold test. First, the court determined whether Reeve had sufficient contacts with the relevant forum. In the case of nationwide service of process, the relevant forum is the United States. The trustee easily satisfied this test, as Reeve was a U.S. national living in the United States. Second, the court determined if its exercise of personal jurisdiction over Reeve comported with "traditional notions of fair play and substantial justice." This required balancing the burden placed on the defendant against the interest in furthering the policies of the Bankruptcy Code.

Reeve argued that litigating in Delaware would amount to an undue burden on him because he lived in Idaho, he was in difficult financial circumstances, and he had to pay his defense costs out of his own pocket. The court held that Reeve had failed to prove that he could not bear the financial burden of litigating in Delaware. The court accepted as true the trustee's allegations in the complaint that Reeve had received over \$7 million in improper pre-petition transfers and that he was a major player in a "grand scheme to enrich the insiders at the expense of legitimate creditors." The court also noted that Reeve provided no evidence concerning his wealth or income.

More significantly, the court held that even had Reeve been able to establish that litigating the case in Delaware would impose a burden on him, the burden would not have outweighed the benefits of having the case heard in the trustee's selected forum.

The court noted the trustee's complaint asserted claims against five other "insiders" who allegedly received improper transfers and concluded it would place "an improper burden and expense on the estate to sever the Reeve transactions to a court in Idaho while the other five defendants remain in this court." Also, the court said it was conceivable that the other five insiders would be called as witnesses to demonstrate the scheme alleged in the complaint, requiring the trustee to present his case twice. "The expense of this duplicative litigation would be borne by the creditors for whose benefit the fraudulent transfers actions are meant to serve."

Finally, the court pointed out that 28 U.S.C. §1409, providing for venue in proceedings under the Bankruptcy Code, specifically authorizes commencement of actions in the court in which the chapter case is pending and allows for a very limited exception for claims under \$11,725, which can only be brought in the district in which the defendant resides. Thus, Congress had to know that most avoidance actions in large cases would result in an inconvenience to the defendants and Congress contemplated that insider defendants, such as Reeve, would be haled into court where the chapter case is pending.

In the end, the court's decision seemed to depend on several factors: the fact that the defendant was alleged to be an insider and not a third party; the failure of the defendant to submit a detailed affidavit in support of his claim that litigating the case in Delaware would impose an undue burden on him; the size of the case (and therefore the amount of the alleged improper transfers received by the defendant); and finally, the context of the case, which included claims against multiple parties asserted in a single case.

According to the brief submitted by Reeve's attorneys, the personal jurisdiction challenge raised by Reeve was a matter of first impression in Delaware's bankruptcy courts: "No adversary proceeding defendant with minimum contacts to the United States has yet invoked before a bankruptcy court in this jurisdiction the undue-burden safeguard." The brief raised several other questions merely to preserve them for a later appeal, including whether a federal district court may exercise jurisdiction over a defendant who has the requisite minimum contacts with the United States but not with the specific district (not yet decided by the U.S. Supreme Court) and whether Bankruptcy Rule 7004(d) can authorize extraterritorial service of process under Rule 4(k)(1)(C) of the Federal Rules of Civil Procedure even though it is not a federal statute (not yet decided by the 3<sup>rd</sup> Circuit or the Supreme Court). These are questions that are likely to be raised by defendants in other preference actions until they are fully answered by the district court, the 3<sup>rd</sup> Circuit and ultimately the U.S. Supreme Court.