

# Trouble in Texas: Resignations and Scandal

David Conaway reports from Texas as Judge David Jones resigns as bankruptcy judge amid scandal



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## The fall of Enron

Texas is the second largest US state (after Alaska). It is an economic engine in the US, fuelled primarily by the oil and gas industry. When Houston-based Enron Corporation filed its Chapter 11 case in the Southern District of New York in 2001, Texans were mad. Enron was the largest US Chapter 11 case at the time. It also sparked one of the largest corporate scandals in US history.

## The rise of Texas

In late 2020, the *Houston Chronicle* featured Judge Jones as “the judge who saved the Texas bankruptcy practice”, heralding a dramatic shift of filings of complex Chapter 11 cases from Delaware and New York to Texas. Since Enron, the Texas

Bankruptcy Court, specifically the Southern District of Texas in Houston, became one of the Chapter 11 “hotspots”, challenging the supremacy of Delaware and the Southern District of New York. In the first half of 2023, 16 of the 20 largest Chapter 11 cases were filed in the Southern District of Texas. This trend is similar in prior years, as the Southern District of Texas became the “go-to” venue for large Chapter 11 cases.

## The rise of Venue- and Judge-shopping

In 2021, a US Senate Judiciary Committee conducted hearings on possible fraud in Chapter 11 cases, including receiving testimony from Georgetown Law School Professor, Adam Levitin. The essence of Levitin’s testimony was that “Big Law” handpicked not only the venue, but the

particular judge for filing cases. The Purdue Pharma Chapter 11 case was specifically filed in the Southern District of New York, White Plains Division. Only Judge Robert Drain handled cases filed in that Division. He had a reputation for approving Chapter 11 plans that contained broad non-consensual releases of non-debtors. The Purdue Pharma Chapter 11 Plan releases were approved by Judge Drain, but are now on appeal before the US Supreme Court, with oral arguments having occurred on 6 and 7 December 2023. Since the Senate hearings, the New York Bankruptcy Court has made all case assignments random.

Levitin also noted that a “Big Law” law firm ran into trouble in Delaware, when a judge was “furious” regarding the terms of DIP financing proposed by Big Law and also denied portions of the law firm’s fee application. According to Levitin, Big Law “took its business” to other judicial districts, particularly the



Southern District of Texas, where large Chapter 11 filings surged.

### The rise of Judge Jones

Judge Jones was instrumental in restructuring the Texas Bankruptcy Court that facilitated the Chapter 11 filing surge by implementing a case assignment procedure, where all “complex” Chapter 11 cases were automatically assigned to two judges: Judge Jones or Judge Marvin Isgur. Thus, companies, and their counsel, knew with certainty the identity of their judge, if they filed Chapter 11 in the Southern District of Texas. By contrast, Delaware’s case assignment procedure is random.

As national Chapter 11 counsel for creditors, we have appeared in dozens of Chapter 11 cases before Judges Jones and Isgur. Within a period of a week, Judge Jones presided over first day hearings for two cases in particular: Party City (18 January 2023) and Serta Simmons (24 January 2023). In both cases, in connection with the Debtors’ motions for DIP financing, Judge Jones’ statement was “I see you are going very fast. ... I want to go faster”. He offered final approval of the DIP financing, when only interim approval was requested by the Debtors. Final approval of the DIP financing on a first day basis violates the Bankruptcy Code, which requires 20 days’ notice to all creditors.

### The fall of Judge Jones

On 4 October 2023, a lawsuit filed by a *pro se* litigant and former shareholder of energy and construction company McDermott International, which had gone through a Chapter 11 restructuring approved by Judge Jones in 2020, accused Judge Jones of failing to disclose his relationship with a partner at Jackson Walker LLP.

The law firm of Jackson Walker LLP was frequently selected as local counsel by “Big Law” for their Chapter 11 cases in

Texas. A Jackson Walker partner Elizabeth Freeman has been in a romantic relationship with Jones and they were living together. Simultaneously, Jackson Walker and Freeman specifically were working on many cases over which Judge Jones presided. Many details of the Jones-Freeman relationship have been publicly reported in press, including in articles in the *Wall Street Journal*. Jones initially denied any wrongdoing and asserted that he had no duty to recuse himself from presiding over these cases because they were not married (they were “co-habiting”) and they did not comele funds. However, the *Wall Street Journal* subsequently reported Jones and Freeman co-owned a home and had a joint bank account. Additionally, neither Freeman nor Jackson Walker disclosed potential conflicts required by the Bankruptcy Code in connection with applications to be retained and be paid by the Debtors.

Despite Jones’ denials, after the *Wall Street Journal* and other media reports of alleged facts, the Chief Judge of the US Court of Appeals for the Fifth Circuit filed a formal ethics probe into Jones’ failure to disclose the romantic relationship. Initially, Judge Jones did not resign, but all his cases were re-assigned to other Texas bankruptcy judges. Shortly after the initiation of the formal ethics probe, Jones resigned from the Bankruptcy Court altogether.

The potential impact and fallout from the scandal has yet to be determined. To date, the United States Trustee has sought to disgorge fees from Jackson Walker of at least USD 13 million. Also, any orders and rulings by Judge Jones, where recusal should have occurred, are potentially subject to being set aside. It remains to be seen whether further investigations will occur regarding Judge Jones, Freeman, Jackson Walker and Big Law.

Also, the Texas Bankruptcy Court has come under pressure to modify its case assignment procedure to become random, as in Delaware and New York.

### The fall of Texas?

Since Judge Jones’ resignation, several large Chapter 11 cases have been filed in the Bankruptcy Court for the District of New Jersey, such as Rite Aid and WeWork, prompting speculation that New Jersey will become the new “hotspot”. New Jersey is also the venue for home goods retailer Bed Bath & Beyond’s Chapter 11 case as well as Johnson & Johnson subsidiary LTL Management’s second attempt to resolve its mass talc liabilities via bankruptcy. As one sanguine New York attorney noted, New Jersey and Delaware are much closer than Texas.

As a result of the Jones fallout, will companies switch to Delaware, New York, or New Jersey as restructuring venues? 2024 will be an interesting year.

### Coda

It is common for foreign-based companies to file Chapter 11 in the US to implement restructuring objectives. Such companies and their counsel essentially have had their choice of forum and judges for the Chapter 11 filings. Scandinavian Airlines is a recent example, where the Swedish-based company filed Chapter 11 in the Southern District of New York to implement its restructuring. Houston-based energy and construction giant McDermott International filed Chapter 11 in Houston in 2020.

In September 2023, McDermott announced that it entered into a transaction support agreement (TSA) for a financial restructuring and commenced a Dutch Wet Homologatie Onderhands Akkoord (WHA) proceeding and a UK restructuring plan (RP) under Part 26A of the UK Companies Act 2006 (CA 2006). On 9 October 2023, McDermott filed an ancillary Chapter 15 proceeding in Houston, primarily for the purpose of US approval and enforcement of the Dutch and English restructuring plans in the US. ■



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