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EXPERT ANALYSIS

The Supreme Court's Structured Dismissal Of Bankruptcy Court Authority: *Czyzewski v. Jevic Holding Corp.*

By Kevin Morse, Esq.
Arnstein & Lehr

For bankruptcy practitioners, a hallmark of the Roberts Supreme Court has been its open disdain for any attempt on the part of bankruptcy judges to exercise authority beyond the strictest interpretation of the Bankruptcy Code.[1]

The Supreme Court's intent to continue dismantling the equitable authority of bankruptcy courts was apparent from the Dec. 7 oral arguments in *Czyzewski v. Jevic Holding Corp.*[2]

The only real issue after oral arguments was how the court wanted to structure its dismantling of the 3rd U.S. Circuit Court of Appeals' approval of a "structured dismissal" that violated the Bankruptcy Code's statutory priority scheme.[3]

Jevic Transportation Inc. was a trucking company headquartered in New Jersey. When its business began to decline in 2006, a subsidiary of the private equity firm Sun Capital Partners acquired it in a leveraged buyout financed primarily by CIT Group. The company ceased substantially all its operations, and its employees received notice of their impending terminations May 19, 2008.

The next day, Jevic filed a voluntary Chapter 11 petition in the U.S. Bankruptcy Court for the District of Delaware. A group of Jevic's terminated truck drivers filed a class action against Jevic and Sun alleging violations of the federal Worker Adjustment and Retraining Notification Act, 29 U.S.C.A. § 2101, and similar New Jersey employment provisions.

Generally, a portion of WARN Act claims, when liquidated, is entitled to priority in the Bankruptcy Code's distribution scheme and the remainder is classified as a general unsecured claim.[4] Meanwhile, the appointed committee of unsecured creditors brought a fraudulent-conveyance action against CIT and Sun on the estate's behalf based on the failed leveraged buyout.

In March 2012, after nearly four years of disagreement, the committee, Jevic, CIT and Sun reached an agreement without the consent of the drivers. The settlement provided for a release of all claims against each other, including the fraudulent-conveyance action against CIT and the WARN Act claims against Sun.

The parties also agreed Sun would permit Jevic's remaining $1.7 million to be transferred to a trust, to pay tax and administrative creditors first and then the general unsecured creditors on a pro rata basis. Also, Jevic's Chapter 11 case would be dismissed.

The settlement was a so-called structured dismissal, which is a final disposition of a Chapter 11 case with specific conditions controlling the final distribution of assets and the relationship between the parties. The settlement was structured so that the drivers would not receive any distribution on account of their priority wage and WARN Act claims.

The drivers were completely excluded from the settlement while general unsecured creditors — a lower-priority class of creditors — were to receive a distribution in exchange for, among other things, the release of the drivers' WARN Act claims.

The drivers objected to the proposed structured dismissal on the basis that it distributed estate property to lower-priority creditors under Section 507 of the Bankruptcy Code. The Bankruptcy Court overruled the drivers' objection on the ground that "dire circumstances" existed for the structured dismissal, including the fact that there was no realistic prospect of a distribution to any parties without the settlement.

The Bankruptcy Court also held that due to Sun's liens on all Jevic's property, a conversion to Chapter 7 would not provide a Chapter 7 trustee with any funds "to operate, investigate, or litigate." The U.S. District Court for the District of Delaware affirmed the approval of the settlement. The drivers appealed to the 3rd Circuit.

In *In re Jevic Holding Corp.*,[5] the 3rd Circuit clearly went beyond the text of the Bankruptcy Code in upholding a settlement and dismissal that resulted in payments that contravened the Bankruptcy Code's priority scheme.

In authorizing the settlement, the 3rd Circuit and lower courts bifurcated the single issue of whether the settlement and dismissal distributing the bankruptcy estate's assets outside the priority scheme was valid into two questions: whether structured dismissals are authorized under the Bankruptcy Code and whether the proposed settlement satisfied the well-established criteria for settlements under Federal Rule of Bankruptcy Procedure 9019.

By bifurcating the validity issue in this manner, the courts circumvented the appellant wage claimants' arguments that the settlement was, for all intents and purposes, a sub rosa Chapter 11 plan that avoided distribution to the wage claimants and allowed the courts to rely on the premise that payment to some creditors — even if outside the priority scheme — is better than none.

Not surprisingly, the drivers filed a petition for writ of certiorari, which was granted. The question before the Supreme Court was "whether a bankruptcy court may authorize the distribution of settlement proceeds in a manner that violates the statutory priority scheme" of the Bankruptcy Code.

Surprisingly, the issue focused solely on distributions of settlement proceeds; nothing on which the Supreme Court granted certiorari touched on "structured dismissals." The United States filed an amicus brief in support of the petitioning drivers, and it was also allotted time for argument before the high court.

Even with only eight justices — who are highly divided along partisan lines — the Supreme Court will likely find unanimity in limiting a bankruptcy court's power to the strict language of the Bankruptcy Code concerning the authority of the non-Article III bankruptcy court. In two earlier cases, *RadLax Gateway Hotel LLC v. Amalgamated Bank*[6] and *Law v. Siegel*,[7] the Supreme Court was unanimous in its position that bankruptcy courts lack authority to exceed the express language of the code.

After the oral arguments in *Jevic*, the Supreme Court appears set to further uphold its strict limitations on the powers of bankruptcy courts and enforce the strict statutory scheme of priority for the distribution of funds to creditors. It is highly unlikely the Supreme Court will permit the committee, debtor and secured lenders in *Jevic* to circumvent that statutory scheme.

Based on the oral arguments, the only unresolved matter appears to be how — and not whether — the high court will reverse the lower courts' decisions.

At the outset of arguments, Justice Sonia Sotomayor's questioning of the drivers' counsel elicited the fact that the settlement not only precluded recovery for the drivers on their WARN Act claims in the bankruptcy case but also barred them from pursuing nondebtor entities Sun or CIT outside of the bankruptcy case on account of the WARN Act claims or fraudulent transfer.

The justices were well attuned to the concerns raised by the drivers and the government in seeking to unwind the settlement, particularly, as in *Jevic*, where the settlement inequitably distributed all the debtor's assets outside of a plan and dismissed the case without recovery for the alienated creditor class.

The high court further appeared unsympathetic to the "extraordinary circumstances" exception the 3rd Circuit carved out from the statutory priority distribution scheme. The government argued that the 3rd Circuit's extraordinary-circumstances exception would apply to nearly every administratively insolvent bankruptcy case — which can be a significant portion of business cases.

Chief Justice John Roberts seemingly agreed with this analysis in noting that the settling parties' position would look more reasonable the tighter the extraordinary circumstances. Under the 3rd Circuit's exception, according to Chief Justice Roberts, parties' leverage in Chapter 11 plans depends to some extent on their priorities. Yet under the settlement regime respondents proposed, "leverage is reshuffled, and it's more or less who can gang up on who."

In the justices' line of fire, the settling parties remained true to their position that the absolute-priority rule applies only to Chapter 11 plans and that with respect to "distributions of assets other than plans, you're in that discretionary regime."

In support of their position, the respondents relied on Section 363(b) of the Bankruptcy Code, which generally authorizes the use, sale or lease of estate property outside of the ordinary course of business — so long as the use, sale or lease is within the debtor's sound business judgment.[8]

According to the respondents and the 3rd Circuit, the most important aspect of a court's analysis of absolute settlement distributions is the absolute-priority rule — that no junior class of creditors will recover until all senior classes are paid in full — and only in "extraordinary circumstances" can a court circumvent that requirement and authorize a class-skipping or otherwise nonconforming settlement.

In response to the respondents' arguments, the drivers and the government were united in their position that Section 363(b) of the Bankruptcy Code and settlement agreements — whether approved by a bankruptcy court or not — are not a proper means of distributing estate assets.

The petitioners drew a distinct line between the resolution of specific claims or causes of action through a settlement and the ultimate distribution of all estate assets. The only vehicle through which an estate's assets can be finally distributed, according to the petitioners, is a plan.

While the parties' arguments might have appeared to be black and white, the issue raised at oral arguments seemed to the court and analysts to be a more fluid matter.[9]

As stated, certiorari was granted solely on the issue "whether a bankruptcy court may authorize the distribution of settlement proceeds in a manner that violates the statutory priority scheme" of the Bankruptcy Code. This issue did not mention structured dismissals; instead, the court agreed to review only whether settlements can alter the statutory scheme.

Justice Samuel Alito quickly noted, "Something strange seemed to have happened between the petition [for certiorari] stage and the briefing stage in the case." Justice Alito directly removed any question as to whether the court would review the validity of structured dismissals, and the drivers agreed that "we're not asking this court to decide the question of whether structured dismissals are valid."

Structured dismissals will live another day after *Jevic*. But the ruling will likely be another narrow curtailing of bankruptcy courts' authority, which, in this case, is the ability to deviate from the statutory priority distribution scheme to ensure distributions to certain classes of creditors over others. The respondents' reliance on Section 363(b) of the code will likely be the death knell of their argument.

In *RadLax*, the Supreme Court rejected the petitioners' attempted use of the more general "indubitable equivalent" standard for plan confirmation to circumvent a secured creditor's more explicit and enumerated right to credit-bid its secured claim.[10]

For bankruptcy practitioners, a hallmark of the Roberts Supreme Court has been its open disdain for any attempt on the part of bankruptcy judges to exercise authority beyond the strictest interpretation of the Bankruptcy Code.

In dismantling the *RadLax* argument, the court paternalistically held that the "Bankruptcy Code standardizes an expansive (and sometimes unruly) area of law, and it is our obligation to interpret the code clearly and predictably using well-established principles of statutory construction."[11] In other words, the court was not going to permit the debtor to exceed the code's express language..

Similarly, in *Law*, the Supreme Court again emphasized a bankruptcy court's inability to assert authority outside of its enumerated powers, even when the high court's ruling required a Chapter 7 trustee to "shoulder a heavy financial burden resulting from [the debtor's] egregious misconduct," and even though the ruling "may produce inequitable results for trustees and creditors in other cases."[12] The Supreme Court said it will never "permit a bankruptcy court to contravene express provisions of the code."[13]

The 3rd Circuit's solution in *Jevic* — that a distribution to some creditors is better than no distribution at all — was a practical and equitable solution. In all likelihood, the Roberts court will seize on the issue that the accepted solution — the class-skipping settlement — is not explicitly authorized under the Bankruptcy Code and required the Bankruptcy Court and 3rd Circuit to create a new exception.

The 3rd Circuit's resolution contravenes the rulings in *RadLax* and *Law*. Sections 507 and 1129 of the Bankruptcy Code are specific sections relating to the priority and distribution of claims under Chapter 11 of the code. By authorizing the settlement under Section 363 of the code, the 3rd Circuit used a broader section of the Bankruptcy Code when more specific sections were controlling.

Additionally, even though the results may be inequitable, as in *Law*, the Supreme Court will likely reverse the 3rd Circuit's extraordinary-circumstances exception.

While exceptions to the absolute-priority rule exist — for instance, the injection of new value into the bankruptcy estate[14] — Sections 1129(a)(7) and 1129(b) control the amounts and priority accepting and dissenting creditors are supposed to receive under plans.

It is highly unlikely the Supreme Court will permit the Bankruptcy Court to contravene these express provisions of the Bankruptcy Code and carve out an exception.

Given the breadth of the 3rd Circuit's extraordinary-circumstances exception, inferior courts in the 3rd Circuit have already started to contrast themselves with the *Jevic* settlement and dismissal.[15]

Narrowly tailored structured dismissals that comply with the requirements of the Bankruptcy Code will continue to exist and play a vital role in bankruptcy practice after *Jevic*. In all likelihood, after *Jevic* a bankruptcy court's ability to use its purported equitable powers and discretion[16] will be further curtailed even when its use would be the most practical and beneficial resolution.

NOTES

[1] *See, e.g., Stern v. Marshall,* 564 U.S. 462 (2011) (the bankruptcy court cannot enter judgment on state law counterclaims); *RadLax Gateway Hotel LLC v. Amalgamated Bank,* 132 S. Ct. 2065 (2012) (the bankruptcy court cannot deny credit bidding for cause); *Law v. Siegel,* 134 S. Ct. 1188 (2014) (the bankruptcy court cannot use Section 105(a) authority to sanction a vexatious debtor).

[2] No. 15-649, *cert. granted,* 2016 WL 3496769 (U.S. June 28, 2016).

[3] *See* 11 U.S.C.A. § 507.

[4] *See* 11 U.S.C.A. § 507(a)(4).

[5] 787 F.3d 173 (3d Cir. 2015).

[6] 132 S. Ct. 2065 (2012).

[7] 134 S. Ct. 1188 (2014).

[8] *See, e.g., Asarco Inc. v. Elliott Mgmt. (In re Asarco LLC),* 650 F.3d 593 (5th Cir. 2011); *U.S. Bank Trust Nat'l Ass'n (In re AMR Corp.),* 730 F.3d 88 (2d Cir. 2013).

[9] *See* Bill Rochelle, *Supreme Court Will Review Jevic to Rule on Structured Dismissals and Gift Plans,* Am. Bankr. Inst.: Rochelle's Daily Wire, www.abi.org/newsroom/daily-wire/supreme-court-will-review-jevic-to-rule-on-structured-dismissals-and-gift-plans (last visited Jan. 1, 2017); *see also* Douglas Mintz, Robert

Loeb & Monica Perrigino, *Supreme Court to Resolve Circuit Split Over Structured Dismissals,* HARV. LAW SCHOOL BANKR. ROUNDTABLE (Sept. 27, 2016), http://blogs.harvard.edu/bankruptcyroundtable/2016/09/27/supreme-court-to-resolve-circuit-split-over-structured-dismissals/.

[10] *RadLax,* 132 S. Ct. at 2072

[11] *Id.* at 2073.

[12] *Law,* 134 S. Ct. at 1197-98.

[13] *Id.* at 1197.

[14] *Bank of Am. Nat. Trust & Sav. Ass'n v. 203 N. LaSalle Street P'ship, 526 U.S. 434 (1999); Liquidating Trust Comm. v. Freeman (In re Del Biaggio),* 834 F.3d 1003 (9th Cir. 2016); *Dish Network Corp. v. DBSD N. Am. Inc. (In re DBSD N. Am. Inc.),* 634 F.3d 79 (2d Cir. 2011).

[15] *See In re Petersburg Regency LLC,* 540 B.R. 508, 531 (Bankr. D.N.J. 2015) ("this case represents an ever better one than *Jevic* for a structured dismissal because all non-insider creditors are included and there is no class-skipping.").

[16] *See* 11 U.S.C.A. § 105(a).

Kevin H. Morse is a partner in the bankruptcy and creditors' rights group and the litigation practice group in the Chicago office of **Arnstein & Lehr**. He represents businesses, financial institutions, trustees and individuals in a range of insolvency-related matters, including out-of-court restructurings, distressed sales, in-court Chapter 7 and 11 bankruptcy cases, and litigation. Before joining Arnstein & Lehr, he served as judicial law clerk for U.S. Bankruptcy Judge Thomas B. Donovan of the Central District of California.