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Feature

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Did *Jevic* Provide a Gift for Those Who Want to Give One?

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Rarely does a substantive bankruptcy issue make it to the U.S. Supreme Court with the reach that the Court was first asked to decide in *Czyzewski v. Jevic Holding Corp*.[1] The question is whether under any circumstance a bankruptcy court can approve settlement payment distributions that violate statutory priorities. Principally under *Jevic*'s facts[2] and how that issue for *certiorari* was framed, the viability of so-called "gifting" was at stake, potentially upending without regard to circumstance a quarter-century-old doctrine that has survived precisely because, when it comes to chapter 11 reorganizations, circumstance often matters.

Because the petitioners in *Jevic* invited the Court to wander in that busy neighborhood, other class-skipping payment conventions were also at risk. But all that was dodged when the petitioners narrowed the issue in their merits brief to the more limited world of structured dismissals. On that more focused question, the Court returned a majority decision that disallows nonconsensual priority-skipping payments in structured dismissal orders, leaving their broader use elsewhere untouched by its holding. No far-flung new rules were adopted, and its holding merely underscored the importance the Court places on the Bankruptcy Code's priority scheme when concluding a chapter 11 case, regardless of how "rare" the circumstance.

Rehabilitation vs. Strict Adherence to Priorities: Bases and Timing Matter

Circumstance should nevertheless continue to matter during those stages of a case when rehabilitation is achievable — even if it is uncertain. After all, *Jevic* involved end-of-case distributions, whereas *Aweco* and *Iridium* (the cases setting up the circuit split that *Jevic* was expected to resolve) did not.[3] Justice Stephen Breyer, who wrote for the majority, observed that Bankruptcy Code priorities are "fundamental" to the Code's "operation" and are "the cornerstone of reorganization practice and theory."[4] If the petitioners in *Jevic* had not recast their question[5] to allow the Court to sidestep the thornier issue dealt with in *Aweco* and *Iridium*, would the Court have instead reminded us of its view expressed in earlier decisions that this cornerstone was built on the foundation of debtor rehabilitation?[6]

Dicta Suggests *Iridium* Got It Right

Citations from *dicta* in *Jevic* provide a clue — if not the answer. Although the Fifth Circuit in *Aweco* determined that priority rules must be rigidly followed regardless of when a settlement is approved, the Court in *Jevic* opted (without need given the narrowed issue before it) to cite to *Iridium* and *Kmart*[7] for when in a case those rules might have flexibility.

Kmart tells us that early case payments on pre-petition vendor claims might be okay if truly necessary for rehabilitation to benefit the whole. In addi-

1 *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973 (2017). For ABI's coverage of this case, visit abi.org/abisearch.

2 For a discussion of the facts in *Jevic*, *see* Anna Haugen, Courtney A. McCormick and Kathryn Z. Keane, "Re-'Structuring' Dismissal Flexibility: An Analysis of the Supreme Court's *Jevic* Decision," XXXVI *ABI Journal* 5, 12, 71-73, May 2017, *available at* abi.org/abi-journal.

3 The circuit split the Court thought it was to resolve when granting *certiorari* was whether the absolute priority rule applies to distributions affected by pre-plan settlement agreements. The Fifth Circuit in *Matter of AWECO Inc.*, 725 F.2d 293 (5th Cir. 1984), required as much without exception, whereas the Second Circuit in *In re Iridium Operating LLC*, 478 F.3d 452 (2d Cir. 2007) (and the Third Circuit by its lower decision in *Jevic*), did not.

4 *Jevic*, 137 S. Ct. at 984.

5 A "bait-and-switch" in the words of Justice Clarence Thomas in his dissent. *Jevic*, 137 S. Ct. at 988 (citation omitted).

6 *See, e.g., NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 528 (1984), *superseded by statute*, 11 U.S.C. § 1113 ("[T]he fundamental purpose of reorganization is to prevent the debtor from going into liquidation."); *Caplin v. Marine Midland Grace Tr. Co. of New York*, 406 U.S. 416, 422-23 (1972) ("In contradistinction to a bankruptcy proceeding where liquidation of a corporation and distributions of its assets is the goal, a Chapter X proceeding is for the purposes of rehabilitating the corporation and reorganizing it.").

7 *In re Kmart Corp.*, 359 F.3d 866 (7th Cir. 2004).

tion, *Iridium* tells us that priority rules are not always absolute when payment is made — even if well into a case but outside the statutory confines of a plan. A lesson from both is that rehabilitation can sometimes edge out strict adherence to priorities where a need and its foundation exist. Each seems to acknowledge that pre-plan payments can skip priorities for the right reasons if supported by credible evidence that withstands strict scrutiny from the bankruptcy court when approving them.

In that regard, *Iridium* and *Kmart* are not unlike *Aweco*: "Concrete facts"[8] are necessary. The difference is that under *Aweco*, those facts must demonstrate with certainty that early payments to junior claimants will not jeopardize full repayment to seniors later in the case (*i.e.*, absolute priority applies from case inception through dismissal). It is on that point that the *dicta* in *Jevic* matters most.

Justice Breyer distinguished the "interim" distributions made in *Iridium* and *Kmart* from the "final" ones made under the structured dismissal order in *Jevic*, where in the former "'[i]t is difficult to employ the rule of priorities' because 'the nature and extent of the Estate and the claims against it are *not yet fully resolved*.'"[9] This suggests that *Iridium* got it right in its split from *Aweco*, so long as priority-skipping distributions advance a "significant offsetting bankruptcy-related justification."[10]

Credible Foundation and Consideration for Priorities as a Check Against Skirting Procedural Safeguards

If the foregoing were the case, then *Jevic* could have been read to allow a priority-skipping gift, so long as delivery occurs before case resolution or outside a plan. However, Justice Breyer went further and observed that the distributions to be made as part of the dismissal order in *Jevic* were akin to transactions that "courts have refused to allow on the ground[s] that they circumvent the Code's procedural safeguards."[11]

On that point he cited *Braniff* and *Lionel*,[12] two early entrants for the proposition that § 363 sales cannot preordain the rights and claims of interested parties free of the rigors of the plan-confirmation process by what amounts to a *sub rosa* plan. Although a transaction might occur early in a case and ostensibly effect an "interim" distribution, if the practical effect is to dictate the terms of a later plan, a court must ensure that the "hurdles erected in chapter 11" are "scale[d]."[13]

Whether the Court intended to resuscitate *sub rosa* plan-type arguments is unclear because it also cited *Chrysler*[14] with apparent approval. The § 363 sale in *Chrysler* came within weeks of the petition filing and clearly preordained the outcome of the case and estate distributions. Objectors argued that the sale violated absolute priority and amounted to a *sub rosa* plan. The Second Circuit affirmed the bankruptcy court's approval of the sale and distinguished *Braniff* because the *Chrysler* sale did not "dictate" or "arrange" by contract the terms of a future plan,[15] nor was absolute priority violated. Secured creditors supported the sale, their claims swamped the estate, and the bankruptcy court "demonstrated proper solicitude" for priorities and "deemed it essential that the Sale in no way upset that priority."[16]

> **[A]lthough nothing in the Bankruptcy Code "authorizes" priority-skipping payments in connection with a dismissal order, nothing in the Bankruptcy Code expressly prohibits them.**

Jevic leaves us with what appears to be a narrow reading of the Bankruptcy Code when testing distributions by their conformance with the Code's priority scheme if by agreement or order other distributions are effectively fixed. If it is clear no better alternative exists — as in *Chrysler* and *Iridium* but that Justice Breyer disagreed was so in *Jevic* — flex in the joints might be appropriate.

This is not to say that there is room to deviate from priorities in connection with dismissal orders absent affected-party consent. On that, *Jevic*'s holding is clear,[17] but circumstance continues to matter. Flexibility might turn on the extent and credibility of the record offered in support for why those circumstances should outweigh sharp adherence to priorities earlier in a case.

Unanswered Questions: Payments from Non-Estate Funds and Where Justice Gorsuch Might Land

As a final point, *Jevic* never takes gifting head-on. It does not mention the term, nor does it cite to *SPM*,[18] the seminal case that inspired its later use in chapter 11. It could rightly be said that in doing so, *SPM* has often been stretched beyond its facts in that *SPM* not only involved a chapter 7 debtor, the gift was undeniably from the lender's own funds. The *Iridium* court, for its part, managed to sidestep *SPM*'s potential carryover to chapter 11 because, unlike in *SPM*, in *Iridium* the lenders' liens had not been finally determined.[19]

However, in *Jevic*, a good chunk of the money that was to fund the settlement appeared to come directly from the lender's pocket.[20] Whether that distinction merits a difference is left unsaid by the Court's opinion. Its holding implies that

8 *In re AWECO Inc.*, 725 F.2d at 300.
9 *Jevic*, 137 S. Ct. at 987 (quoting *Iridium*, 478 F.3d at 464) (emphasis added in *Jevic*).
10 *Id.* at 986.
11 *Id.*
12 *In re Braniff Airways Inc.*, 700 F.2d 935 (5th Cir. 1983); *In re Lionel Corp.*, 722 F.2d 1063 (2d Cir. 1983).
13 *In re Braniff Airways Inc.*, 700 F.2d at 940 (citing 11 U.S.C. §§ 1125 (disclosure), 1126 (voting), 1129(a)(7) (best interest of creditors test) and 1129(b)(2)(B) (absolute priority rule)).
14 *In re Chrysler LLC*, 576 F.3d 108 (2d Cir. 2009), *vacated as moot*, 592 F.3d 370 (2d Cir. 2010), *cert. granted, judgment vacated sub nom., Indiana State Police Pension Tr. v. Chrysler LLC*, 558 U.S. 1087, 130 S. Ct. 1015, (2009), *vacated sub nom., In re Chrysler LLC*, 592 F.3d 370 (2d Cir. 2010).
15 576 F.3d at 117, n. 9.
16 *Id.* at 118.
17 *Jevic*, 137 S. Ct. at 978 ("[A] distribution scheme ordered in connection with the dismissal of a Chapter 11 case cannot, without the consent of the affected parties, deviate from the basic priority rules that apply under the primary mechanisms the Code establishes for final distributions of estate value in business bankruptcies.").
18 *In re SPM Mfg. Corp.*, 984 F.2d 1305 (1st Cir. 1993).
19 *In re Iridium Operating LLC*, 478 F.3d at 461 ("[W]e need not decide if *SPM* could ever apply to Chapter 11 settlements, because it is clear that the Lenders did not actually have a perfected interest in the cash on hand.").
20 Of the $3.7 million payment that was to be made by Jevic's two lenders (CIT and Sun Capital Partners), $2 million was to be "deposited" by CIT. *Jevic*, 137 S. Ct. at 981.

it does not, but that might read too much into the opinion. The Court was not asked to and did not address the issue of priority-skipping payments — even if in connection with a dismissal order — if the payment is confined to what is clearly a party's separate funds, not estate property.

Query where Justice Neil Gorsuch,[21] a known textualist, would come out on the issue first presented and as later narrowed in *Jevic* if the gift was closer to the one made in *SPM* or what appeared to be the case for more than half the proposed distribution in *Jevic*. For example, § 1129(b)(2)(B)(ii) prohibits payments of "any property" on account of interests and claims only insofar as they are made in connection with a plan. This plain language helps explain the results in *Armstrong*[22] and *DBSD*,[23] which disallowed gifts to equity "on account of" their interests under a plan — even when, in the case of *DBSD*, they derive from collateral carveouts. No such direct ban exists elsewhere in the Bankruptcy Code. As Justice Breyer noted, although nothing in the Bankruptcy Code "authorizes" priority-skipping payments in connection with a dismissal order,[24] nothing in the Bankruptcy Code expressly prohibits them.

Conclusion

Jevic closed the door on nonconsensual priority-skipping payments in connection with dismissal orders but left open a window for their use elsewhere. Precisely when they would be used in a case was left unsaid, although a faint line appears to have been drawn roughly before priorities become absolute by statute. Circumstance should continue to matter when operating outside the Fifth Circuit, and perhaps there too should the issue, as first presented in *Jevic*, again find its way to the Court. abi

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21 Justice Gorsuch, having not yet been confirmed, did not participate in the *Jevic* ruling. For further discussion, *see* Joanne Lee and Charles Tabb, "Would *Jevic* Have Come Out Differently with Gorsuch?," *The Bankruptcy Strategist*, May 2017, *available at* lawjournalnewsletters.com/2017/05/01/would-jevic-have-come-out-differently-with-gorsuch/?slreturn=20180511091407.

22 *In re Armstrong World Indus. Inc.*, 432 F.3d 507 (3d Cir. 2005).

23 *In re DBSD N. Am. Inc.*, 634 F.3d 79, 97 (2d Cir. 2011) ("[The] Code extends the absolute priority rule to 'any property' ... not 'any property not covered by a senior creditor's lien.'").

24 *Jevic*, 137 S. Ct. at 984.