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Business Track

The Implications of *Czyzewski v. Jevic* to Business Bankruptcies

Daniel F. Dooley, Moderator
MorrisAnderson; Chicago

David Going
Armstrong Teasdale LLP; St. Louis

William C. Heuer
Westerman Ball Ederer Miller Zucker & Sharfstein, LLP
New York

Jeffrey N. Pomerantz
Pachulski Stang Ziehl & Jones; Los Angeles

Marshall C. Turner
Husch Blackwell LLP; St. Louis

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ABI Midwestern Bankruptcy Institute- Kansas City

Dan Dooley – MorrisAnderson – Chicago
Dave Going – Armstrong Teasdale – St Louis
Bill Heuer – Westerman Ball Ederer Miller Zucker & Sharfstein- Uniondale, NY
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Jevic- Basic Case History

- Jevic Transportation, Inc., the operating sub of Jevic Holdings, was a $200M annual revenue New Jersey trucking company employing over 1,900 employees. Jevic was acquired by a subsidiary of Sun Capital Partners in a leveraged buyout in 2006.
- CIT agented a 5 bank financing which was in excess of $50M to fund the acquisition.
- In April 2008, CIT advised Jevic that they would only continue to provide funding in a Chapter 11 proceeding with the company to be liquidated and Dan Dooley of MorrisAnderson to become CRO and manage the process with management and the MorrisAnderson team. Dan Dooley became CRO in late April 2008 and planned a liquidating Chapter 11.
- On Monday May 19, 2008, Jevic publicly announced to customers, suppliers and employees that Jevic would be shut down and liquidated and that a Chapter 11 filing was imminent. Jevic gave the WARN notice and terminated a large number of people except employees needed for the liquidation, terminal management and drivers who were scheduled to deliver customer loads.
- The DIP Budget provided for $3M of payments to terminated employees for heathcare self insurance run off claims and all accrued vacation pay. But no WARN liability payments.

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Jevic- Basic Case History (Continued)

- On Tuesday May 20, 2008 (the next day), Jevic and related legal entities filed for Chapter 11 in Delaware. Jevic was a liquidating case from the start with no intention of pursuing a sale or Plan of Reorganization.
- Over the next 3 weeks all Jevic business operations were shut down and all assets were marshalled for sale, and all employees except a small wind down group had been terminated. So virtually all employee terminations occurred less than 60 days from the date of the WARN Notice and employees were not paid for the WARN period.
- Jevic and Sun, as owner, were served with multiple WARN Act class action suits shortly after filing Chapter 11; all eventually were consolidated into one class action lawsuit in the bankruptcy court
- The Creditors Committee requested and was granted by Bankruptcy Court (with consent of the Debtors) approval to file lawsuits on behalf of the Jevic estate for an alleged fraudulent conveyance against both Sun and CIT arising from the LBO
- MorrisAnderson liquidated all the assets of Jevic in the Chapter 11 over 2008-2010 including the prosecution and collection of all preference claims

3

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Jevic- Basic Case History (continued)

- CIT was eventually fully paid and approximately $2M of secured debt remained, which was a last out participation in the CIT facility by Sun. Coincidentally the Debtor had approximately $2M of cash in the bank subject to the secured creditor interest
- Claims were approximately: $1M of unpaid administrative professional fee claims, $500K of 503(b)(9) claims, priority tax claims and other administrative claims, $12M of WARN claims (potentially up to $8M would have priority status), and the unsecured claims pool of $10M
- There were two unresolved litigation cases (WARN which had to be defended by Jevic and Sun, and Fraudulent Conveyance which the Committee was pursuing for the Debtor against Sun and CIT). Jevic had no unencumbered assets to fund either defense or prosecution.
- Case was clearly administratively insolvent without the parties agreeing to some type of a negotiated settlement
- The option of converting to a Chapter 7 would have left the estate with no unencumbered assets except the Committee's fraudulent conveyance lawsuit, but there was no cash to fund future litigation

4

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Jevic- Basic Case History (continued)

- The Debtor convened two in-person meetings of all parties. Between Sun and CIT a pot of $3.7M was accumulated which could be used to resolve all matters. The WARN claimants participated in the mediation meetings but no universal settlement was reached.
- In order to avoid a Chapter 7 conversion, the Debtor, Sun, CIT and the Committee created a 9019 Settlement where the two secured lenders (Sun and CIT) would settle the fraudulent conveyance litigation, all parties involved in the settlement would get releases, CIT would pay $2.0M and Sun would assign $1.7M of their secured cash to pay 1. professional fees, 2. administrative and priority claims, with 3. with a small dividend (8%) paid to the unsecured creditors, and 4. the Chapter 11 case would end as a structural dismissal. The WARN claimants received nothing but retained their rights to pursue their WARN litigation against Jevic and Sun. Of course Jevic had no unencumbered assets, so it was judgment proof.
- This 9019 Settlement became the issue that the WARN claimants appealed, with further support from the US Trustee and DOJ offices, that eventually came before the US Supreme Court because the 9019 Settlement Distributions skipped over the WARN Priority Wage Class.

5

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Procedural History of the Case

- The WARN plaintiffs and the U.S. Trustee objected to the combined 9019 Settlement and the structured dismissal motion, because the settlement skipped the WARN plaintiffs with priority claims and priority tax claimants, but made distributions to junior class unsecured creditors, it violated the Absolute Priority Rule.
- The U.S. Trustee also contended that structured dismissals are not permitted under the Bankruptcy Code.
- The 9019 Settlement and structured dismissal motion were modified to also pay tax priority claims
- The Bankruptcy Court overruled both objections and approved the what he termed as the "least worst alternative" which was the proposed 9019 Settlement and structured dismissal.
  - The court acknowledged that the Code does not expressly authorize structured dismissals, but found that the relief was justified by dint of the "dire circumstances" present in the case.
  - There was "no prospect of a confirmable Chapter 11 plan" and conversion to Chapter 7 was not a viable option because the trustee would lack the resources necessary to fund the case.
- The court rejected the U.S. Trustee's and The WARN plaintiffs argument that the court could not approve the settlement because it violated the Absolute Priority Rule, reasoning that the Bankruptcy Code's priority scheme does not extend to settlements.
- The WARN plaintiffs and U.S. Trustee appealed to the District Court, which affirmed the Bankruptcy Court's decision. The WARN plaintiffs and U.S. Trustee appealed to the Third Circuit. No stay pending appeal was requested at any level except in the Bankruptcy Court which denied a stay

6

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Issues the 3rd Circuit Considered on Appeal

- The Third Circuit hearing the appeal addressed two issues:

(1) Whether a structured dismissal is permissible under the Bankruptcy Code and

(2) If so, whether a settlement in the context of a structured dismissal must follow the Absolute Priority Rule.

- The Third Circuit noted conflicting case law from other Circuits: *In re AWECO, Inc.*, 725 F.3d 293 (5th Cir. 1984) and *In re Iridium Operating LLC*, 478 F.3d 452 (2d Cir. 2007)
- As to (1), the Third Circuit explained that while section 349 "contemplates that dismissal will typically reinstate the pre-petition state of affairs … it also explicitly authorizes the bankruptcy court to alter the effect of dismissal 'for cause'—in other words, the Code does not strictly require dismissal of a Chapter 11 case to be a hard reset."
- The Third Circuit highlighted that even the WARN plaintiffs acknowledged that both a liquidating plan and Chapter 7 were not viable options.
- Accordingly, it held, "absent a showing that the structured dismissal has been contrived to evade the procedural protections of the plan confirmation or conversion process, a bankruptcy court has discretion" to order a structured dismissal.
- As to (2), the Third Circuit adopted the Second Circuit's *Iridium* standard, a multi-factored approach in which the most important factor is that a settlement be "fair and equitable" but under which a noncompliant settlement could be approved if "the remaining factors weighed heavily in favor" of approving a settlement.

7

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Issue Presented Before the US Supreme Court

- Oral argument was heard by the 8 justice court in December 2016
- The ONLY ISSUE presented to the Supreme Court for consideration is:
  - Whether a bankruptcy court may authorize the distribution of settlement proceeds in a manner that violates the statutory priority scheme (i.e. the Absolute Priority Rule)?
- The layman's basic argument "for" affirming is simply that the Bankruptcy Code does not prohibit distributing proceeds not in conformance with the Absolute Priority Rule when dismissing a case if there are exceptional circumstances "for cause" supporting such distribution
- The layman's basic argument "against" affirming is simply that the Bankruptcy Code does not specifically allow distributing proceeds not in conformance with the Absolute Priority Rule (APR) in any situation and Chapter 11 Plan and Chapter 7 distributions explicitly must follow the APR
- The U.S. Trustee Office took up the Appeal (as amicus curiae) because of its belief that the Absolute Priority Rule is key foundation of bankruptcy law and as a matter of policy it must be strictly followed in all cases
- However, it's common practice to violate the Absolute Priority Rule in bankruptcy cases? Examples:
  - Pre-petition wage and tax payments
  - Loan Roll-ups and Professional Carve-outs
  - Critical vendor payments and Gifting

8

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The Supreme Court Ruling

- Plaintiffs successfully recharacterized the issue before the Supreme Court as follows:
  - Whether a bankruptcy court has the legal power to order this priority-skipping kind of distribution scheme in connection with a Chapter 11 dismissal?
- This is a much narrower issue than broader issue upon which certiorari was granted and was not subject to a "Circuit Split" in opinions
- The Supreme Court Ruling decided by a 6-2 vote to Reverse and Remand as follows:
  - Bankruptcy courts may not approve structured dismissals that provide for distributions that do not follow ordinary priority rules without the consent of affected creditors (same standard as Chapter 11 Plans)
  - This is essentially the same rule as applies in Chapter 11 Plans of Reorganization (or Liquidation)
  - Two Judges dissented based upon the plaintiffs recharacterization of the issue before the court as 1. the recharacterized issue not subject to a Circuit Split, so certiorari would not have been granted on it and 2. this potentially opens the door for future litigants to recharacterize issues before the court in a more favorable way to their case

9

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Key Comments in the Supreme Court Opinion

- Acknowledged that there are only three ways to end a Chapter 11 case- Plan or Reorganization (or Liquidation), Conversion to Chapter 7 or Dismissal
- Acknowledged that the Code does not identify whether the priority system must be followed under a dismissal where a total case reset to the beginning is impossible (i.e. a structured dismissal), such as Jevic
- Although the Court specifically did not sanction the use of Structured Dismissals, it acknowledged that they are increasingly used and referenced the American Bankruptcy Institute's definition of a structured dismissal
- Discussed that interim case distributions (as opposed to final case distributions) that deviate from the priority rules can be permissible if they serve other Code objectives. Specifically listed were first day wage orders, critical vendor orders and roll-up financings
- Found that the non-priority case ending distributions in Jevic did not serve other Code objectives
- Concerned that granting bankruptcy courts the ability to use discretion to skip priorities over an objecting creditor in a case ending distribution could become a more general rule in the future. The reasoning was that it is difficult to give precise content to the concept of "sufficient reasons" to not follow the priority system
- Priority system has long been considered fundamental to final case distributions and Congress wouldn't have been silent of how to make distributions in a (structured) dismissal case if it intended to authorize a major departure from this fundamental

10

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Implications of the Decision on Future Chapter 11's

- The Jevic case "had" the potential to really disrupt Chapter 11s:
  - A broad reversal of the original issue before the Supreme Court could have dramatically impaired a company's ability to function effectively in a Chapter 11 by limiting a company's ability to fund essential payments
  - A broad reversal of the original issue before the Supreme Court could have made it more difficult for lenders to use Chapter 11 to liquidate collateral thru a 363 sale process or a liquidation
- Appears to sanction use of the Doctrine of Necessity to make non-priority following distributions that are not final case distributions if done to address other Code objectives
- Appears to have sanctioned Structured Dismissals while being careful to specifically not do so
- It seems quite possible that Supreme Court saw the Plaintiff's recharacterization of the issue before the court as a way to address a much narrower issue and deal with the broader priority scheme issue that had the potential of dramatically changing Chapter 11s via implication and not direct ruling

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So What's Going to Happen to Jevic Now?

- How will the Bankruptcy Court Judge eventual handle the reversal and remand?
  - This will be a difficult case to put the "genie back in the bottle"
  - Does the Judge get the same result with equitable mootness? (not well regarded in the 3rd Circuit)
  - With a "No Assets" Case, who would do the work to try to recover the $3.7M of money distributed years ago?
  - Do you only try to recover the distributions only to creditors lower in priority than the WARN priority claimants ($1.2M)?
  - Doesn't the distributed money if disgorged from creditors simply go back to the secured creditors anyway?
  - What happens to the settled fraudulent conveyance lawsuit?
  - Could the secured creditors CIT and Sun as a practical matter potentially get the benefit of the deal without paying the full agreed price?
  - Do the parties involved attempt to renegotiate a new deal?

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What Might Have Been Done Differently in the 9019 Settlement?

- Who knows if any of these would have worked but some options would have been:
  - Do the 9019 Settlement as a stand alone settlement and let time pass before doing the Structured Settlement
  - Pay the WARN creditors out of the settlement instead of the lower priority creditors
  - Have the secured creditor take the remaining funds in the case subject to its lien, seek a Structured Dismissal and attempt to do the same settlement outside of the bankruptcy court