No. 15-649

In the Supreme Court of the United States

CASIMIR CZYZEWSKI, ET AL., PETITIONERS

v.

JEVIC HOLDING CORP., ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

DONALD B. VERRILLI, JR.
Solicitor General
Counsel of Record
BENJAMIN C. MIZER
Principal Deputy Assistant Attorney General
MALCOLM L. STEWART
Deputy Solicitor General
SARAH E. HARRINGTON
Assistant to the Solicitor General
MICHAEL S. RAAB
DANA KAERSVANG
Attorneys

Department of Justice
Washington, D.C. 20530-0001
SupremeCtBriefs@usdoj.gov
(202) 514-2217

RAMONA D. ELLIOTT
Deputy Director/
General Counsel
P. MATTHEW SUTKO
Associate General Counsel
WENDY COX
Trial Attorney
Department of Justice
Executive Office
For United States Trustees
Washington, D.C. 20530

QUESTION PRESENTED

Whether a bankruptcy court may authorize a distribution of settlement proceeds that violates the priority scheme established by the Bankruptcy Code, over the objection of priority creditors whose rights are impaired by the proposed distribution.

TABLE OF CONTENTS

Page

Interest of the United States 1
Statement 1
Discussion 10
A. The court of appeals' decision is incorrect 11
B. The courts of appeals are divided on the question presented 19
C. The question presented is important and recurring ... 21
Conclusion 23

TABLE OF AUTHORITIES

Cases:

Andrus v. *Glover Constr. Co.*, 446 U.S. 608 (1980) 14
AWECO, Inc., In re, 725 F.2d 293 (5th Cir.), cert. denied, 469 U.S. 880(1984) 9, 19
Bull v. *United States*, 295 U.S. 247 (1935) 22
Burlingham v. *Crouse*, 228 U.S. 459 (1913) 11
Cybergenics Corp., In re, 226 F.3d 237 (3d Cir. 2000) 18
Hillman v. *Maretta*, 133 S. Ct. 1943 (2013) 14
Iridium Operating LLC, In re, 478 F.3d 452 (2d Cir. 2007) 9, 19, 20
Law v. *Siegel*, 134 S. Ct. 1188 (2014) 15
Martin v. *Wilks*, 490 U.S. 755 (1989) 16
Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. *Anderson*, 390 U.S. 414 (1968) 3, 16
PWS Holding Corp., In re, 303 F.3d 308 (3d Cir. 2002) 18
United States v. *Bryan*, 13 U.S. (9 Cranch) 374 (1815) 13

Statutes and rule: Page

Bankruptcy Code, 11 U.S.C. 101 *et seq.*:

11 U.S.C. 103(a) 2, 13, 15
11 U.S.C. 349 4
11 U.S.C. 349(b) 4, 13
11 U.S.C. 349(b)(2) 3
11 U.S.C. 349(b)(3) 3
11 U.S.C. 362 11
11 U.S.C. 503(b)(1)(B) 22
11 U.S.C. 507 .... 2, 3, 11, 13, 14, 15
11 U.S.C. 507(a) 13
11 U.S.C. 507(a)(2) 22
11 U.S.C. 507(a)(4) 2, 5
11 U.S.C. 507(a)(5) 2
11 U.S.C. 507(a)(8) 22
11 U.S.C. 510 14
11 U.S.C. 522 11
11 U.S.C. 541(a) 3, 16
11 U.S.C. 541(a)(3) 3
11 U.S.C. 541(a)(6) 3, 16
11 U.S.C. 544(b) 18
11 U.S.C. 547 5
11 U.S.C. 548 5
11 U.S.C. 548(a) 18
11 U.S.C. 701 *et seq.* 1
11 U.S.C. 726(a) 13, 14
11 U.S.C. 726(a)(1) 3
11 U.S.C. 726(a)(2) 3
11 U.S.C. 1103 3
11 U.S.C. 1107 18
11 U.S.C 1112 3

Statutes and rule—Continued: Page

11 U.S.C. 1112(b)(1) 22
11 U.S.C. 1112(4)(I) 22
11 U.S.C. 1122 1
11 U.S.C. 1123 1
11 U.S.C. 1129(a)(8) 13
11 U.S.C. 1129(a)(9)(A)-(D) 3
11 U.S.C. 1129(a)(9) 2, 13, 14, 20
11 U.S.C. 1129(a)(9)(C) 22
11 U.S.C. 1129(a)(9)(D) 22
11 U.S.C. 1129(b) 14
11 U.S.C. 1141 1
11 U.S.C. 1141(d) 11
11 U.S.C. 1222(a)(2)(B) 14
11 U.S.C. 1332(a) 14

N.J. Stat. Ann. § 34:21-2 (West 2011) 5

Worker Adjustment and Retraining Notification Act, 29 U.S.C. 2102 5

28 U.S.C. 1408 21

Bankr. R. 9019 .... 3, 16

Miscellaneous:

Collier on Bankruptcy (Alan N. Resnick & Henry J. Somme reds., 16th ed. 2011):

Vol. 3 4
Vol. 7 2

GAO, *Corporate Bankruptcy: Report to the Chairman, Committee on the Judiciary*, U.S. Senate, Appx. III at 42 (Sept. 2015), http://www.gao.gov/assets/680/672696.pdf 21

H.R. Rep. No. 835, 103d Cong., 2d Sess. (1994) 12

Miscellaneous—Continued: Page

H.R. Rep. No. 996, 102d Cong., 2d Sess. (1992) 11, 12

S. Rep. No 1106, 95th Cong., 2d Sess. (1978)............ 2, 12, 13

In the Supreme Court of the United States

No. 15-649

CASIMIR CZYZEWSKI, ET AL., PETITIONERS

v.

JEVIC HOLDING CORP., ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

INTEREST OF THE UNITED STATES

This brief is submitted in response to this Court's order inviting the Solicitor General to express the views of the United States. In the view of the United States, the petition for a writ of certiorari should be granted.

STATEMENT

1. a. A company may file a bankruptcy petition pursuant to either Chapter 7 or Chapter 11 of the Bankruptcy Code. In a Chapter 7 bankruptcy, the company's pre-petition assets are liquidated and distributed to creditors. 11 U.S.C. 701 *et seq.* A Chapter 11 bankruptcy, in contrast, is implemented through a "plan" that assigns to "classes" the various allowed claims and specifies the treatment each class of claims shall receive, in exchange for a discharge of debts as provided by the Code. 11 U.S.C. 1122, 1123, 1141.

In a Chapter 11 plan, each secured creditor typically is designated as a class unto itself. See 7 *Collier on Bankruptcy* ¶ 1122.03[3][c] at 1122-15 (Alan N. Resnik & Henry J. Sommer eds., 16th ed. 2011) (*Collier*). Among unsecured claims, the Code assigns "priority" to certain claims because of their "special social importance." S. Rep. No. 1106, 95th Cong., 2d Sess. 4 (1978). Section 507—which applies to bankruptcies filed under Chapters 7 and 11, see 11 U.S.C. 103(a)—identifies claims entitled to priority and specifies the order in which they must be paid. 11 U.S.C. 507. Unsecured claims with priority include certain administrative expenses incurred during the bankruptcy proceeding; employee wages and benefits that were earned but not paid in the six months before the bankruptcy petition was filed; consumer deposits; and taxes. *Ibid.*

Under Section 507, wage claims have fourth priority, and contributions to employee benefit plans have fifth priority. 11 U.S.C. 507(a)(4) and (5). A bankruptcy court generally may confirm a proposed Chapter 11 plan only if each holder of a priority claim under Section 507 receives cash or deferred cash payments (depending on the circumstances) equal to the value of the claim as of the effective date of the plan, unless a particular claimholder "agree[s] to a different treatment of [its] claim." 11 U.S.C. 1129(a)(9). In addition to requiring that priority claimants be paid in full (unless they consent to different treatment), the Code establishes further prerequisites to plan confirmation with respect to non-priority unsecured creditors. But full payment of Section 507 priority claims is mandatory and independent of how other unsecured creditors may be treated under a plan. In a Chapter 7 liquidation, unsecured creditors with Section 507 priority claims are paid "in the order specified" in Section 507, 11 U.S.C. 726(a)(1), and other unsecured claimants may not receive any payments unless the priority claims are paid in full, 11 U.S.C. 726(a)(2).

While a bankruptcy case is pending, any legal claims the estate has against its creditors and others may be litigated or settled, usually by the debtor in possession or a trustee. In some circumstances, a bankruptcy court may authorize a committee of creditors to pursue claims on behalf of the estate. 11 U.S.C. 1103. Any proceeds from litigation or from settlement become estate property subject to distribution under the normal rules of priority. 11 U.S.C. 541(a)(3) and (6). A bankruptcy court may approve settlement of an estate claim if, after notice and a hearing, the court determines that the settlement is fair and equitable. Bankr. R. 9019; see *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc.* v. *Anderson*, 390 U.S. 414, 424 (1968).

If the estate of a Chapter 11 debtor lacks sufficient funds to pay the priority claimholders in full in accordance with Section 1129(a)(9)(A)-(D) (typically cash or deferred payments), and the priority claimants do not agree to different treatment in the plan, the case can either be converted to a Chapter 7 liquidation or dismissed. 11 U.S.C 1112. An order of dismissal in a bankruptcy case ordinarily has the effect of vacating the orders entered during the proceedings, and it "revests the property of the estate in the entity in which such property was vested immediately before the commencement of the case" (usually the debtor). 11 U.S.C. 349(b)(2) and (3). The "objective" of a dismissal "is to undo the title 11 case, insofar as is practicable, and to restore all property rights to the position they occupied at the beginning of such case." 3 *Collier* ¶ 349.01[2]. The bankruptcy court has discretion to leave its orders in force "for cause," 11 U.S.C. 349, such as to protect the reliance interest of a good-faith purchaser, 3 *Collier* ¶ 349.01[2]. If a Chapter 11 case is dismissed, creditors retain their pre-petition claims against the debtor and can pursue them outside bankruptcy. 11 U.S.C. 349(b).

2. This case arises out of the bankruptcy of respondent Jevic, a trucking company, following its acquisition by respondent Sun Capital Partners (Sun) in a leveraged buyout. Pet. App. 2a. Sun financed the transaction by borrowing against Jevic's assets. C.A. J.A. 733-734 (July 28, 2014, bankruptcy court opinion). When Jevic subsequently refinanced the loan, respondent CIT Group/Business Credit, Inc. (CIT) became the primary lender and obtained a lien on all of Jevic's assets. Pet. App. 36a; C.A. J.A. 734. When Jevic's financial condition continued to deteriorate, Sun agreed to guarantee $2 million of Jevic's debt in exchange for CIT's agreement not to foreclose on Jevic's assets for a period of time. Pet. App. 2a; C.A. J.A. 735, 1161. Shortly before that agreement expired, Jevic's board of directors authorized a bankruptcy filing. Pet. App. 2a. Jevic then ceased substantially all of its operations, notified its employees that they would be fired, and filed a Chapter 11 bankruptcy petition. *Id.* at 2a-3a. When that petition was filed, Jevic owed approximately $53 million to CIT and Sun, who were first-priority secured creditors. *Id.* at 3a, 36a n.2.

As relevant here, two suits were filed in the bankruptcy court, one seeking to establish the estate's liabilities and the other asserting claims of the estate. First, petitioners—a group of Jevic's employee truck drivers—alleged violations of state and federal laws known as Worker Adjustment and Retraining Notification (WARN) Acts, which require in some circumstances that an employer give written notice to employees at least 60 days before laying them off. Pet. App. 3a (citing 29 U.S.C. 2102; N.J. Stat. Ann. § 34:21-2 (West 2011)). The bankruptcy court granted summary judgment to petitioners on their claims against Jevic. *Id.* at 5a & n.2. An estimated $8.3 million dollars of petitioners' WARN Act claim is a priority wage claim under 11 U.S.C. 507(a)(4). Pet. App. 6a.

Second, after an Official Committee of Unsecured Creditors (Committee) was appointed to represent the interests of Jevic's unsecured creditors, the bankruptcy court authorized the Committee to pursue a fraudulent-conveyance action against Sun and CIT on behalf of the estate. Pet. App. 3a. The Committee alleged that Sun, with CIT's assistance, had "acquired Jevic with virtually none of its own money" and "hastened Jevic's bankruptcy by saddling it with debts that it couldn't service." *Ibid.* The Committee's complaint alleged, *inter alia*, that Sun's and CIT's liens were avoidable and that certain assets with significant value must be disgorged to the estate. See C.A. J.A. 679-854.

The bankruptcy court ultimately denied in part and granted in part Sun's and CIT's motion to dismiss the fraudulent-conveyance action, concluding that the Committee had adequately pleaded claims of fraudulent transfer and preferential transfer under 11 U.S.C. 547 and 548. Pet. App. 3a-4a. The court explained that "[a]n overly leveraged buyout that leaves the target company with unreasonably small capital—where it is reasonably foreseeable that the target will soon thereafter become insolvent—may provide the requisite factual predicate for an avoidance action grounded in fraudulent transfer law." C.A. J.A. 751. The court concluded that the Committee's complaint sufficiently alleged that CIT had played a critical role in facilitating a series of transactions that recklessly reduced Jevic's equity, increased its debt, and shifted the risk of loss to its other creditors. Pet. App. 4a.[1]

The Committee, Jevic, CIT, and Sun then sought to negotiate a settlement of the Committee's fraudulent-conveyance action. Pet. App. 4a. By that point, Jevic's only assets were the fraudulent-conveyance claim against CIT and Sun, and $1.7 million in cash, which was subject to Sun's lien. *Ibid.* The parties to the negotiations ultimately reached an agreement that would accomplish four things: (1) those parties would exchange releases of their claims against each other, and the bankruptcy court would dismiss the estate's fraudulent-conveyance action with prejudice; (2) CIT would pay $2 million into an account earmarked to pay Jevic's and the Committee's legal fees and other administrative expenses, but not otherwise available for distribution to creditors; (3) Sun would assign its lien on Jevic's remaining $1.7 million to a trust that would pay tax and administrative creditors, with the remain-

---

[1] Because the complaint cited the Uniform Fraudulent Transfer Act rather than the relevant provisions of state law, the bankruptcy court dismissed without prejudice the Committee's claim that the transaction also violated state law. C.A. J.A. 753. The court explained, however, that the Committee's ultimate success on the state-law claim (once properly pleaded) "will likely mirror its success on" the federal fraudulent-conveyance claim. *Ibid.*

der to be distributed on a pro rata basis to the general unsecured creditors (but not to petitioners, who are higher-priority creditors); and (4) Jevic's Chapter 11 bankruptcy would be dismissed. *Id.* at 5a-6a. The proposed settlement did not provide for any payment to petitioners on their higher-priority WARN Act claims, and it left Jevic with no assets to satisfy those claims outside bankruptcy. *Id.* at 5a-7a.

3. The Committee, Jevic, CIT, and Sun moved in the bankruptcy court for approval of the settlement. See Pet. App. 53a. Petitioners and the United States Trustee opposed that motion, on the grounds that the proposed settlement would distribute estate assets to creditors of lower priority than petitioners, in contravention of the Bankruptcy Code's priority scheme, and that the Code does not contemplate or permit relief other than a confirmed plan, a Chapter 7 liquidation, or an outright dismissal. *Id.* at 7a, 53a, 57a.

In an oral ruling, the bankruptcy court granted the motion to approve the settlement, which it described as a "global resolution" reached by "certain of the parties." Pet. App. 55a; see *id.* at 53a-66a. The court acknowledged that this type of resolution "is neither favored nor commonplace"; that "no express[] provision in the code" authorizes the "distribution and dismissal contemplated by the settlement motion"; and that "the proposed distributions are not in accordance with the" Code's priority scheme. *Id.* at 57a-58a. The court nevertheless approved the proposed disposition, explaining that, "because this is not a plan, and there is no prospect of a confirmable plan being filed, the absolute priority rule is not a bar to approval of this settlement." *Id.* at 58a. Because CIT and Jevic had liens on all of the estate's assets, the bankruptcy court determined that a disposition that would make money available to the unsecured creditors and some priority creditors was in the interest of the creditors as a group. *Id.* at 58a, 61a.

The bankruptcy court acknowledged that its calculus would change if the Committee's fraudulent-conveyance claim were ultimately successful, but it noted several "independent hurdles the Committee would have to clear before it would actually see a material recovery out of the litigation." Pet. App. 60a. The court also noted that the estate (unlike CIT and Sun) had no available funds and would have a difficult time retaining counsel to pursue the case, notwithstanding the possibility of retaining contingency counsel or a Chapter 7 Trustee to continue the litigation. *Id.* at 61a. The bankruptcy court also concluded that petitioners were not prejudiced by the other parties' agreement. *Ibid.* The court reasoned that petitioners' "claim against the estate [was] presently, effectively worthless given that the estate lack[ed] available unencumbered funds to satisfy it if it were allowed." *Ibid.*

4. The district court affirmed. Pet. App. 33a-44a. While recognizing that "the settlement does not follow the absolute priority rule," the court held that this deviation was "not a bar to the approval of the settlement as [the settlement] is not a reorganization plan." *Id.* at 42a. The court also concluded that "the settlement was in the best interest of the estate." *Id.* at 41a.

5. The court of appeals affirmed. Pet. App. 1a-32a. The court first held that a bankruptcy court has discretion to order a "structured dismissal" of a Chapter 11 bankruptcy, at least when there is "no prospect of a

confirmable plan" and conversion to Chapter 7 would not be "worthwhile." *Id*. at 14a-15a; see *id.* at 12a-15a. The court further held that a bankruptcy court may order such a "structured dismissal" even when the "settlement[] * * * skip[s] a class of objecting creditors in favor of more junior creditors." *Id.* at 15a; see *id.* at 15a-21a.

The court of appeals observed that the Second and Fifth Circuits had rendered conflicting decisions regarding the propriety of such structured dismissals Pet. App. 17a-18a. It sided with the Second Circuit, which had held that "the absolute priority rule 'is not necessarily implicated' when 'a settlement is presented for court approval apart from a reorganization plan.'" *Id.* at 18a (quoting *In re Iridium Operating LLC*, 478 F.3d 452, 453 (2d Cir. 2007) (*Iridium*)). The court of appeals rejected the approach adopted by the Fifth Circuit, which had held "that the 'fair and equitable' standard applies to settlements, and 'fair and equitable' means compliant with the priority system." *Id.* at 17a (quoting *In re AWECO, Inc.*, 725 F.2d 293, 298 (5th Cir.) (*AWECO*), cert. denied, 469 U.S. 880 (1984)). Instead, the court followed the Second Circuit in holding that, although "'compli[ance] with the Code's priority scheme must be the most important factor for the bankruptcy court to consider when determining whether a settlement is "fair and equitable" under Rule 9019,' * * * a noncompliant settlement could be approved when 'the remaining factors weigh heavily in favor of approving a settlement.'" *Id.* at 18a (quoting *Iridium*, 478 F.3d at 464).

The court of appeals held that the settlement and structured dismissal of Jevic's bankruptcy case was "the least bad alternative since there was 'no prospect' of a plan being confirmed and conversion to Chapter 7 would have resulted in the secured creditors taking all that remained of the estate in 'short order.'" Pet. App. 21a (quoting C.A. J.A. 32). While acknowledging that "the exclusion of [petitioners] certainly lends an element of unfairness," the court considered the critical question to be whether the settlement serves the interests of the "estate and the creditors as a whole," not "one particular group of creditors." *Id.* at 22a.

Judge Scirica dissented. Pet. App. 23a-32a. He stated that "the bankruptcy court's order undermined the Code's essential priority scheme." *Id.* at 23a. Although Judge Scirica would have followed the Second Circuit in permitting settlements contrary to the priority scheme in "extraordinary circumstances," he disagreed with the majority's conclusion that "this appeal presents an extraordinary case." *Id.* at 24a. He explained that it is "not unusual" for a debtor to enter Chapter 11 bankruptcy proceedings with liens on all of its assets and with the goal of liquidating. *Id.* at 31a & n.5 (citing study showing that 22% of surveyed companies entered Chapter 11 with secured claims exceeding the value of the estate). He further explained that, "to the extent that the only alternative to the settlement was a Chapter 7 liquidation, that reality was, at least in part, a product of the [settling parties'] own making." *Id.* at 25a.

DISCUSSION

The court of appeals erred in approving the purported settlement agreement in this case. The court's decision deepens an existing circuit conflict about whether the court in a Chapter 11 bankruptcy case may approve, over the objection of a priority claimant whose rights would be impaired, a proposed "settlement" that distributes estate assets in a manner inconsistent with the Bankruptcy Code's priority scheme. The question presented is important and recurring, and the three courts of appeals that have addressed the issue govern the vast majority of large bankruptcy cases filed in the United States. Indeed, because any corporate debtor with an affiliate organized under the laws of Delaware can file a bankruptcy in the Third Circuit, the decision in this case can be expected to have a substantial impact on future Chapter 11 cases. Review by this Court is warranted to correct the court of appeals' erroneous decision.

A. The Court Of Appeals' Decision Is Incorrect

The Bankruptcy Code prescribes a detailed scheme for resolving claims against an insolvent debtor. The Code reflects Congress's careful balancing of competing interests and provides important protections for both debtors and creditors. See H.R. Rep. No. 996, 102d Cong., 2d Sess. 12-13 (1992) (1992 Report). Debtors are protected by, for example, the automatic stay that generally freezes efforts to collect pre-petition debts, 11 U.S.C. 362; the Code provisions that exempt certain property of individual debtors from liquidation or distribution to pay pre-petition debts, 11 U.S.C. 522; and the discharge of liability on debts that are addressed in a plan of reorganization, 11 U.S.C. 1141(d). See *Burlingham* v. *Crouse*, 228 U.S. 459, 473 (1913) (noting that the Bankruptcy Code "give[s] the bankrupt a fresh start with such exemptions and rights as the [bankruptcy] statute left untouched"). Creditors, in turn, are protected by, *inter alia*, the detailed priority scheme set forth in the Code, which requires that certain types of creditors be paid in full through a bankruptcy before other types of creditors may receive any distribution. 11 U.S.C. 507. In this case, the court of appeals held that a bankruptcy court may upend that carefully balanced system by abrogating the rights of nonconsenting priority creditors in order to benefit the debtor and lower-priority creditors. The Bankruptcy Code does not allow such a disposition.

1. The "uniform national bankruptcy system * * * is designed to achieve two equally important objectives": "to provide honest debtors who have fallen on hard times the opportunity for a fresh start in life," and "to protect creditors in general by preventing an insolvent debtor from selectively paying off the claims of certain favored creditors at the expense of others." 1992 Report 12-13; H.R. Rep. No. 835, 103d Cong., 2d Sess. 32-33 (1994) (1994 Report) (same). Recognizing the "inevitable temptation among creditors to fiercely compete over the debtor's limited funds," Congress designed a system "in which the claims of all creditors are considered fairly, in accordance with established principles rather than on the basis of the inside influence or economic leverage of a particular creditor." 1992 Report 13; 1994 Report 33.

To achieve fair and orderly disposition of competing creditors' claims, Congress created a priority system that gives special protection to a "narrow[] set of specified claims, including certain tax obligations and limited past due wages to a debtor's employees," by requiring that such claims "be paid in full" before non-priority (or lower-priority) creditors receive "any distribution." 1992 Report 13; 1994 Report 33; see S. Rep. No. 1106, 95th Cong., 2d Sess. 4 (1978) (1978 Report) (noting that the Code "giv[es] priority in the distribution of assets of the debtor's estate to certain claims with special social importance"). The priority system is codified at 11 U.S.C. 507, which applies to most bankruptcy proceedings, including cases filed under Chapters 7 and 11, see 11 U.S.C. 103(a), and generally "affect[s] claims of unsecured creditors," 1978 Report 4.

Section 507 provides that enumerated "expenses and claims have priority in the * * * order" specified. 11 U.S.C. 507(a). Because that provision "appl[ies] in a case under chapter 7, 11, 12, or 13," 11 U.S.C. 103(a), it governs Jevic's Chapter 11 bankruptcy. In the bankruptcy context, the term "priority" has long been used to refer to claims that are entitled to be paid before other claims. See *United States* v. *Bryan*, 13 U.S. (9 Cranch) 374, 387 (1815). A bankruptcy court cannot confirm a Chapter 11 plan that impairs the rights of a priority creditor unless the creditor consents. 11 U.S.C. 1129(a)(8) and (9). If a bankruptcy estate lacks sufficient funds to pay priority creditors in full and the priority creditors do not consent to less favorable treatment, the Code provides for conversion to Chapter 7, where priority creditors still must be paid first. 11 U.S.C. 726(a). In the alternative, such a case may be dismissed, leaving creditors free to pursue their claims outside bankruptcy. 11 U.S.C. 349(b).

The court below held that a bankruptcy judge may dispose of a Chapter 11 case in a manner that is not provided for in the Code and that violates the priority scheme set forth in Section 507. The court thus approved a bankruptcy disposition that furthered the interests of the debtor and non-priority creditors at the expense of objecting priority creditors. Nothing in the Code permits such a disposition, which contravenes the carefully balanced scheme Congress has created.

Although the priority scheme set forth in Section 507 is not inviolable, Congress has specified the circumstances in which a court may deviate from that scheme, and none of those circumstances was present here. See, *e.g.*, 11 U.S.C. 726(a) (incorporating "equitable subordination" exception in 11 U.S.C. 510, which permits a bankruptcy court to reorder particular priority claims in a Chapter 7 liquidation); 11 U.S.C. 1129(a)(9), 1222(a)(2)(B), 1332(a) (authorizing plan confirmation when a priority creditor consents to abrogation of its rights). "'Where Congress explicitly enumerates certain exceptions to a general prohibition, additional exceptions are not to be implied, in the absence of evidence of a contrary legislative intent.'" *Hillman* v. *Maretta*, 133 S. Ct. 1943, 1953 (2013) (quoting *Andrus* v. *Glover Constr. Co.*, 446 U.S. 608, 616-617 (1980)). No such contrary legislative intent exists here.

The court below appeared to recognize that a plan of reorganization must provide full payment to Section 507 priority creditors unless such creditors consent to impairment of their rights. Pet. App. 16a-17a.[2] The court concluded, however, that the same principle

---

[2] In discussing the governing legal principles, the court below referred repeatedly to the "absolute priority rule." See Pet. App. 16a-17a. The term "absolute priority rule" is most accurately used to refer to the requirement in 11 U.S.C. 1129(b) that junior classes of creditors may not be paid through a plan of reorganization unless senior classes of creditors either are paid in full or consent to an impairment of their rights. The court of appeals used the phrase to encompass the additional rule that, absent consent, creditors with claims entitled to priority under Section 507 must be paid in full through a plan before any other creditor is paid.

does not apply when the disposition of a bankruptcy case does not involve a plan of reorganization or a liquidation under Chapter 7. *Id.* at 17a. Nothing in the Code supports the court of appeals' conclusion. On the contrary, as noted, the Code specifies that the provisions of Chapter 5 (which includes Section 507) apply to all "case[s] under," *inter alia*, Chapters 7 and 11. 11 U.S.C. 103(a). Regardless of the disposition of Jevic's bankruptcy, it is a "case under" Chapter 11 and is therefore subject to the priority scheme set forth in Section 507.

Bankruptcy is not a free-for-all in which parties or bankruptcy courts may dispose of claims and distribute assets as they see fit. "[I]n exercising [its] statutory and inherent powers, a bankruptcy court may not contravene specific statutory provisions." *Law* v. *Siegel*, 134 S. Ct. 1188, 1194 (2014). The Code provides for three possible dispositions of a Chapter 11 case: (1) a plan of reorganization; (2) conversion to Chapter 7; or (3) dismissal. Nothing in the Code authorizes a court to approve a disposition that is essentially a substitute for a plan but does not comply with the priority scheme set forth in Section 507.

2. The court of appeals erred in upholding the bankruptcy court's disposition of the case on the ground that the Code's priority rules do not apply "to settlements in bankruptcy." Pet. App. 17a. Although *other* parties to the case agreed to the bankruptcy court's disposition, those parties had no authority to settle petitioners' own priority claims. Their agreement consequently provided no sound basis for the court to deviate from the Code's priority scheme at petitioners' expense.

Bankruptcy Rule 9019 authorizes a bankruptcy court to approve a "compromise or settlement." Bankr. R. 9019. That rule typically governs the settlement of a claim of the estate against a third party (including a creditor). A bankruptcy court may not approve a settlement over the objection of a creditor unless the proposed settlement is "fair and equitable." *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc.* v. *Anderson*, 390 U.S. 414, 424 (1968). The "settlement" that the courts below approved disposed of the entire bankruptcy case in a manner that was not fair and equitable because it did not comply with the Code's prescribed treatment of priority claims.

The agreement and the order implementing the purported settlement did not simply convert the estate's fraudulent-conveyance action to assets that would become part of the estate pursuant to 11 U.S.C. 541(a)(6). Rather, the agreement and order took the further step of directing the distribution of those assets in a manner inconsistent with Section 507, over the objection of petitioners, whose rights were impaired by the agreement. Even assuming that the bankruptcy court could have approved that disposition with the consent of all affected parties, it had no authority to abrogate the rights of nonconsenting creditors in a manner not provided for in the Code. The consent of *other* parties who benefitted from the proposed disposition is not a substitute for the consent of the impaired party. Cf. *Martin* v. *Wilks*, 490 U.S. 755, 768 (1989) ("A voluntary settlement in the form of a consent decree between one group of employees and their employer cannot possibly 'settle,' voluntarily or otherwise, the conflicting claims of another group of employees who do not join in the agreement.").

The court of appeals purported to limit its approval of this type of disposition to cases in which a bankruptcy court has "specific and credible grounds to justify [the] deviation." Pet. App. 21a (brackets in original) (citation omitted). But the grounds on which the court relied—that "there was 'no prospect' of a plan being confirmed and that conversion to Chapter 7 would have resulted in the secured creditors taking all that remained of the estate in 'short order,'" *ibid.*—are not permissible reasons to deviate from the Code's priority scheme. If a plan cannot be confirmed and conversion to Chapter 7 is not feasible, the Code provides a third option: dismissal of the bankruptcy.

The court of appeals is correct that, "[a]s in other areas of the law, settlements are favored in bankruptcy." Pet. App. 19a. Both in bankruptcy and in other legal contexts, however, the legal rules that establish parties' rights and obligations provide the background against which parties negotiate towards a settlement. In this context, the priority scheme in Section 507 provides the default rule that will govern if the parties fail to reach a global agreement. The public policy favoring settlement of litigation may justify deviations from the Code's priority scheme when a priority creditor consents to a diminution of his rights. But that policy provides no basis for the disposition that occurred here, in which the bankruptcy court approved the distribution of estate assets in a manner inconsistent with the Code's priority scheme *without* the agreement of the creditors whose rights were impaired.

The bankruptcy court stated that petitioners would not be prejudiced by approval of the settlement because petitioners' "claim against the estate is presently, effectively worthless given that the estate lacks available unencumbered funds to satisfy it if it were allowed." Pet. App. 61a. But the court's view that petitioners' WARN Act claims were worthless rested on its belief that the estate's fraudulent-conveyance claim was too contingent and uncertain to merit pursuit. *Id.* at 60a-61a. If the bankruptcy case had simply been dismissed, petitioners could have pursued a fraudulent-conveyance action against Sun and CIT on their own behalf as creditors of Jevic.

Within the bankruptcy case, Jevic (as debtor in possession) had the exclusive right to pursue (on behalf of all of its creditors) any claim that Jevic's assets were depleted by a fraudulent conveyance. 11 U.S.C. 544(b) (assigning such claims to trustee), 1107 (Chapter 11 debtor in possession has rights of trustee); see 11 U.S.C. 548(a) (trustee has exclusive right to pursue fraudulent-conveyance action in bankruptcy); see also *In re Cybergenics Corp.*, 226 F.3d 237, 241-245 (3d Cir. 2000). When the bankruptcy court approved the purported settlement, the fraudulent-conveyance claim against Sun and CIT (which belonged to Jevic's creditors) was dismissed with prejudice, precluding petitioners from pursuing it outside bankruptcy. See *In re PWS Holding Corp.*, 303 F.3d 308, 313-315 (3d Cir. 2002). The effect of the "settlement" thus was to deprive petitioners, without their consent and without complying with the Code's priority scheme, of a cause of action they could have asserted if the bankruptcy case had simply been dismissed.

B. The Courts Of Appeals Are Divided On The Question Presented

The courts of appeals are divided on the question whether a court presiding over a Chapter 11 bankruptcy can order the distribution of assets in a manner contrary to the Bankruptcy Code's priority scheme without the consent of the priority claimants whose rights are impaired. Of the three circuits to have considered the question, the Second and Third Circuits permit such a result and the Fifth Circuit does not. Particularly because the vast majority of Chapter 11 bankruptcies are filed in those circuits, this Court's review is warranted to resolve that conflict.

In *In re AWECO, Inc.*, 725 F.2d 293, cert. denied, 469 U.S. 880 (1984), the Fifth Circuit held that "a bankruptcy court abuses its discretion in approving a settlement with a junior creditor unless the court concludes that priority of payment will be respected as to objecting senior creditors." *Id.* at 298. In that case, the Fifth Circuit overturned the lower courts' approval of a pre-plan settlement of claims between the estate and a junior creditor that would have distributed assets to the junior creditor without first satisfying the claims of objecting creditors with higher-priority claims. *Id.* at 295-297. The court specifically rejected the view that the Code's priority scheme applied only to plans, not to pre-plan settlement agreements. The court explained that, "[a]s soon as a debtor files a petition for relief, fair and equitable settlement of creditors' claims becomes a goal of the proceedings." *Id.* at 298.

In contrast, the Second Circuit in *In re Iridium Operating LLC*, 478 F.3d 452 (2007), rejected as "too rigid" the rule adopted by the Fifth Circuit. *Id*. at

464. The Second Circuit stated that compliance with the Code's priority scheme "will often be the dispositive factor" in a court's decision whether to approve a proposed settlement. *Ibid.* The court held, however, that "where the remaining factors weigh heavily in favor of approving a settlement, the bankruptcy court, in its discretion, could endorse a settlement that does not comply in some minor respects with the priority rule if the parties to the settlement justify, and the reviewing court clearly articulates the reasons for approving, a settlement that deviates from the priority rule." *Id.* at 464-465.

In this case, the Third Circuit acknowledged the circuit split, Pet. App. 17a-19a, and stated that it "agree[d] with the Second Circuit's approach in *Iridium*," *id.* at 19a. The court held "that bankruptcy courts may approve settlements that deviate from the priority scheme of § 507 of the Bankruptcy Code only if they have 'specific and credible grounds to justify [the] deviation.'" *Id.* at 21a (quoting *Iridium*, 478 F.3d at 466). Respondents assert (Br. in Opp. 15) that "this case presents a different issue than either *AWECO* or *Iridium*, because the settlement here is not a prelude to the eventual confirmation of a reorganization plan." But nothing in those decisions suggests that their holdings are limited to pre-plan settlements that are reached in contemplation of a later confirmable plan. No such plan could be confirmed unless priority creditors either are paid in full or agree to a diminution of their rights, 11 U.S.C. 1129(a)(9), neither of which had happened in *Iridium*.

Respondents are also wrong in asserting (Br. in Opp. 24) that this case is an unsuitable vehicle for addressing the question presented because petitioners "accepted the legal standard set forth in *Iridium*" and "invit[ed]" the Third Circuit to follow it. Petitioners consistently argued that "[n]o provision of the Code authorizes a bankruptcy court to depart from the § 507 priority scheme when approving a settlement," and that petitioners "were therefore entitled to payment of their priority claims in full before any estate assets could be distributed to lower priority claimants." Supp. App. 9a. Although petitioners also argued in the alternative that they would prevail even under the *Iridium* standard, *id.* at 15a, that does not amount to waiver of their primary argument.

This Court's review is particularly appropriate because the vast majority of large bankruptcy cases are brought within the Second, Third, and Fifth Circuits.[3] Going forward, moreover, any corporate debtor with an affiliate organized under the laws of Delaware can file for bankruptcy in a jurisdiction that is bound by the debtor-friendly rule adopted by the court below. 28 U.S.C. 1408.

C. The Question Presented Is Important and Recurring

The possibility of a settlement can be expected to arise in every Chapter 11 case in which the debtor is administratively insolvent. The approach to settlement approved by the court below permits debtors in such cases to collude with sophisticated creditors to reach an agreement about the distribution of estate assets that skips less-favored creditors with priority claims over the objection of those impaired creditors. The Third Circuit's decision may also create undue

---

[3] See GAO, *Corporate Bankruptcy: Report to the Chairman, Committee on the Judiciary, U.S. Senate*, Appx. III at 42 (Sept. 2015), http://www.gao.gov/assets/680/672696.pdf.

pressure for priority creditors to agree to settlements that they would otherwise find unacceptable, for fear of being cut out of the distribution completely with the blessing of the bankruptcy court.

Government creditors like the United States have a particularly strong interest in correcting the court of appeals' erroneous decision. Recognizing that "taxes are the lifeblood of government," *Bull* v. *United States*, 295 U.S. 247, 259 (1935), Congress has provided that certain tax claims have priority status. Taxes incurred after the filing of a bankruptcy petition, for example, are administrative expenses to be paid as a second priority, 11 U.S.C. 503(b)(1)(B), 507(a)(2), and failure timely to pay such taxes is a ground for converting a Chapter 11 case to a Chapter 7 case, 11 U.S.C. 1112(b)(1) and (4)(I). The Code also requires that pre-petition taxes be paid as an eighth priority, 11 U.S.C. 507(a)(8), and makes full payment of such claims a condition of plan confirmation unless the government creditor consents to different treatment, 11 U.S.C. 1129(a)(9)(C) and (D). The Third Circuit's decision creates a significant risk that debtors will collude with junior creditors to squeeze out government tax claims with higher priority. This Court's review is warranted to correct the Third Circuit's erroneous decision.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

DONALD B. VERRILLI, JR.
Solicitor General
BENJAMIN C. MIZER
Principal Deputy Assistant Attorney General
MALCOLM L. STEWART
Deputy Solicitor General
SARAH E. HARRINGTON
Assistant to the Solicitor General
MICHAEL S. RAAB
DANA KAERSVANG
Attorneys

RAMONA D. ELLIOTT
Deputy Director/ General Counsel
P. MATTHEW SUTKO
Associate General Counsel
WENDY COX
Trial Attorney
Department of Justice
Executive Office For United States Trustees

MAY 2016