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The Implications of Jevic on Business

Bankruptcy Cases

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MORE ON JEVIC AND STRUCTURED DISMISSALS. WHY? BECAUSE WHEN THE SUPREME COURT SPEAKS ONCE, WE NEED TO LISTEN TWICE.

JEVIC AND WHAT IS HAPPENING AFTER

In *Czyzewski et al. v. Jevic Holding Corp. et al.*, the Supreme Court held that bankruptcy courts may never approve structured dismissals that provide for distributions that run afoul of the Bankruptcy Code's priority rules without consent of the affected creditors. The Court determined that because the Bankruptcy Code's priority scheme is fundamental to the operation of the Bankruptcy Code, the Court would expect to see some affirmative indication of intent if Congress actually meant to make structured dismissals a backdoor means to achieve the exact kind of nonconsensual priority-violating final distributions that the Bankruptcy Code prohibits in chapter 7 liquidations and chapter 11 plans. The Court noted that bankruptcy courts may approve certain "first-day" orders that seemingly violate the priority scheme but enable a successful reorganization and make even the disfavored creditors better off—like payments to employees for wages and critical vendors. Unlike these first-day orders, structured settlements that contravene the priority scheme of the Code immediately prior to and incorporated in dismissal orders, disfavored the intervening creditors who, according to the Court were clearly not made better off, permanently.

I. Recent Applications of *Jevic*

Since *Jevic*, a number of bankruptcy court decisions have begun to extend *Jevic* beyond structured dismissals to deny other types of relief on the basis that such relief would run afoul of the Bankruptcy Code's priority rules. Other cases seek to limit *Jevic* to end of case (life) situations.

A. *In re Fryar*, 570 B.R. 602 (Bankr. E.D. Ten. 2017).

In *In re Fryar*, the bankruptcy court refused to approve a settlement which would skirt priority rules without consent of the disfavored creditors.

The debtor filed motions to sell property pursuant to sections 363 of the Bankruptcy Code and for approval of compromise. The property to be sold was the debtor's stock interests in two corporations whose value the debtor listed as $900,000. The buyer of these interests was the other shareholder of the companies. The purchase price for these interests was $350,000 cash plus the conveyance by one of the companies of a piece of property which it owned. The stock interests were to be sold free and clear of the tax lien filed by the IRS and any other claim or interest.

However, the settlement did not propose for the IRS lien to attach to the cash proceeds of the sale; but instead, the IRS lien would attach to two other properties which the debtor owned individually on Highway 58, Chattanooga, Tennessee (the "Highway 58 properties"), and the real property being conveyed to the debtor in the settlement. The Highway 58 properties were encumbered by a $531,000 mortgage in favor of Pinnacle Bank. The settlement provided that Pinnacle's lien to be satisfied by the payment to Pinnacle of the $350,000 in cash sales proceeds. However, Pinnacle's collateral was worth only $200,000.

The U.S. Trustee and three unsecured creditors opposed the motion on the basis that Pinnacle was being preferred by receiving $350,000 for a secured claim of only $200,000, and that the priorities set for distribution under the Bankruptcy Code were therefore being reordered to Pinnacle's benefit.

The *Fryar* court noted that the reordering of distribution priorities in a settlement has been the subject of controversy, citing to: the Fifth Circuit opinion in *U.S. v. Aweco, Inc.*, 725 F.3d 292, 298 (5th Cir. 1984) ("[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.") and the Second Circuit opinion in *Motorola, Inc. v. Official Comm. of Unsecured Creditors (In re Iridium Operating LLC)*, 478 F.3d 452, 464 (2nd Cir. 2007) (opting for a more flexible test than *Aweco*). The *Fryar* court ultimately determined that *Jevic* applied, and that *Jevic* required denial of the compromise, because to the court the settlement provided for a distribution in a manner contrary to the Bankruptcy Code's priority scheme and did not involve an acceptable "first-day" deviation. Further, the disfavored creditors did not consent.

In denying the proposed settlement, the *Fryar* court explained that post-*Jevic*, parties seeking approval of settlements that provide for a distribution in a manner contrary to the Bankruptcy Code's priority scheme should be prepared to prove the settlement is not only "fair and equitable" but also that any deviation from the priority scheme for a portion of the assets is justified because it serves a significant Bankruptcy Code-related objective. Additionally, the proposed settlement should state: (i) that objective, such as enabling a successful reorganization or permitting a business debtor to reorganize and restructure its debt in order to revise the business and maximize the value of the estate; (ii) how it furthers that objectives; and (iii) how

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