Jevic in the Consumer Context

Can the Trustee really sell my upside down homestead?

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In *Czyzewski v. Jevic Holding Corp.*, 137 S.Ct. 973 (2017), the court addressed the question of “whether a bankruptcy court has the legal power to order this priority-skipping kind of distribution scheme in connection with a Chapter 11 *dismissal*.” The court answered the question as follows: “In our view, a bankruptcy court does not have such a power. 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 established for final distributions of estate value in business bankruptcies.”

The facts of *Jevic* are worthy of note. In 2006, Sun capital Partners acquired Jevic in a leveraged buyout with funds loaned by CIT group and secured by the companies assets. Two years later, Juvev filed a Chapter 11 and litigation ensued. A group of former employees asserted claims against Jevic for violation of the federal Worker Adjustment and Retraining Notification acts and ultimately obtained a judgment against Jevic including a priority wage claim of $8.3 million. The court also entered an order which allowed the creditors’ committee to sue Sun and Jevic on a fraudulent transfer claim regarding the leveraged buyout. Jevic, Sun and CIT reached an agreement whereby CIT would deposit $2 million to pay the administrative expenses claims of the creditors’ committee, Sun would assign its lien on Jevic’s remaining $1.7 million dollars in assets to a trust which would pay taxes and admin expenses, and make a pro-rated distribution to non-priority creditors while paying nothing to the employees on their priority wage claims. The fraudulent transfer adversary would be dismissed with prejudice and the Chapter 11 would be dismissed subject to the terms of the settlement. (A so-called “structured dismissal.”) The employees and the U.S Trustee objected to the settlement which was approved by the bankruptcy court, affirmed by the district court, and affirmed by the Third Circuit. Those courts essentially recognized that confirmation of a plan was highly unlikely and that the settlement would likely result in a greater distribution than conversion or dismissal.

The court rejected the structured dismissal under the facts of the case stating:

> We recognize that the Third Circuit did not approve nonconsensual priority-violating structured dismissals in general. To the contrary, the court held that they were permissible only in those “rare case9s)” in which courts could find “sufficient reasons” to disregard priority. 787 F.3d, at 175, 186. Despite the “rare case” limitation, we still cannot agree.

The court concluded that creating a rare case exception would open the floodgates where “debtors and favored creditors can be expected to make every case that ‘rare case’” and that “The consequences are potentially serious.” The court did not adopt a per se “no structured dismissals rule” but made it clear that such dismissals should not be approved absent consent to the affected creditors.

Cases which have approved a sale of an over-encumbered homestead.

Perhaps the most cited case is *In re Laredo*, 334 B.R. 401 (Bankr.E.D.IL 2005). The debtors owned a homestead which they valued at $320,235. The property was subject to two contractual liens and a federal tax lien totaling $364,813 so the debtors were $44,578 "underwater" or upside down". The debtors claimed the Illinois homestead exemption of $15,000.

The trustee sought an order authorizing a sale of the property for $380,000 contending that after payment of the two contractual liens and closing costs, there would be insufficient funds to pay the IRS which was superior to the homestead exemption. The court then focuses on 724(b) which alters the normal order of priorities. Essentially the altered order of priority is:

1. Non-avoidable liens (typically a properly perfected mortgage);
2. Admin expenses allowed under 507(a)(1)-(7).
3. Tax liens to the extent there is equity to secure the lien.
4. Non-avoidable liens inferior to the tax liens.
5. Tax liens which are not paid under 724(b)(3).
6. Any remaining amounts are paid to the estate. (In theory, subject to the debtors' exemption claim.)

FYI, 507(a)(2) makes reference to 503(b)(2), which makes reference to 330(a)(1), which makes reference to 326(a). 330(a)(1) includes the attorneys fees and expenses of the trustee. 326(a) is the trustee's statutory commission.

The *Laredo* court states:

> The purpose of the statute is to subordinate tax liens to allow a debtor an opportunity to get a fresh start. "That opportunity would be unavailing if creditors were unwilling to extend credit to a bankrupt. To stimulate that willingness, Congress legislated protection for these administrative creditors." [Internal citations omitted.] *Laredo*, at 411-412.

Note that the quoted language clearly anticipates a failed Chapter 11. In a Chapter 7, there would be no reason for creditors to extend credit to a bankrupt. Only if there is a failed Chapter 11 which is converted to Chapter 7, 724(b) would apply.

The *Laredo* court goes on to state:

> The only parties affected by the operation of §724(b) are the priority claimants and the tax lien creditors. The rights and claims of both junior and senior lienors and the holders of non-priority unsecured claims are left undisturbed. [Internal citations omitted.] *Laredo*, at 412.

This statement clearly mis-comprehends the affect of the statute. By inserting admin claims as the second priority, the statute affects the junior lienholders and the non-priority unsecured creditors, each of which move down one notch in the order of priority. The court's analysis also ignores the affect on the homestead claim of the debtors, but more on that later.

Finally, the *Laredo* court rejected the Debtors' contention that the trustee should not have administered the asset because of the lack of equity in the property. The court construed this as an argument that the trustee should have abandoned the property pursuant to