No. 15-649

IN THE

Supreme Court of the United States

CASIMIR CZYZEWSKI, *et al.*,

Petitioners,

v.

JEVIC HOLDING CORP., *et al.*,

Respondents.

On Writ of Certiorari to the United States Courts of Appeals for the Third Circuit

BRIEF OF LOAN SYNDICATIONS AND TRADING ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Whether the Bankruptcy Code permits a bankruptcy court, without the consent of adversely affected creditors, to approve a settlement dismissing a Chapter 11 case under which settlement proceeds are distributed in disregard of the priorities established in Bankruptcy Code Section 507(a).

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases:

Statutes and Constitution:

Miscellaneous:

INTEREST OF *AMICUS CURIAE*[1]

The Loan Syndications and Trading Association ("LSTA") is a financial trade association whose mission is to promote a fair, orderly, efficient, and growing corporate loan market and to provide leadership in advancing and balancing the interests of all market participants. Its interest in this case lies in promoting transparent, consistent, and reliable rules for determining priority of a debtor's obligations in bankruptcy. Because its members frequently hold obligations of bankrupt businesses, their interest in a reasoned articulation of those rules is paramount.

This case presents the question whether the Bankruptcy Code permits a bankruptcy court, without the consent of adversely affected creditors, to approve a settlement dismissing a Chapter 11 case under which settlement proceeds are distributed in disregard of the priorities established in the Bankruptcy Code. Because those priorities form the backdrop against which businesses engage in lending transactions outside of bankruptcy, and against which they bargain to resolve claims in bankruptcy, it is crucial that those rules remain transparent, consistent, and reliable. *Amicus* has a direct interest in the coherence of that framework;

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[1] This brief was not authored in whole or in part by counsel for a party. No person other than the *amicus* made a monetary contribution intended to fund the preparation or submission of this brief. All parties have consented to the filing of this brief.

we hope this brief will help the Court understand the disruption to commercial expectations that would follow a validation of the decision of the court of appeals.

SUMMARY OF ARGUMENT

1. Predictability, certainty, and reliability are the hallmarks of well-functioning lending markets. Lenders and borrowers bargain intensely over the terms, conditions, and extent of their priority. It has never been the place of the bankruptcy system to foster or facilitate the reshuffling of those priorities with regard to the assets of a debtor's estate. Thus, when there are not enough assets to permit all claimants to be paid in full, the purpose of the proceeding is to minimize the costs of redeploying the assets of the debtor as quickly as possible. There is no place in that proceeding for redistributions of value that flout the prescribed priorities to the disadvantage of nonconsenting creditors. By skipping over the priority claimants in this case – providing a recovery for claims held by general unsecured creditors but not for the priority claims held by the petitioner employees – the dismissal order in this case turned the prescribed priority scheme on its head.

The centrality of a transparent system of priority rules that replicate pre-insolvency arrangements is widely recognized as foundational to a well-functioning credit market. Indeed, the most basic guidelines for the design of insolvency systems worldwide start from the premise that those systems will operate with transparency to replicate pre-bankruptcy priorities with respect to the debtor's assets. The startling departure from such a system wrought by "priority-skipping" settlements like those approved by the court of appeals directly contradicts the most basic precepts of a well-functioning insolvency regime.

2. The costs of tolerating priority-skipping settlements are considerable. Instead of relatively well-anchored negotiations about the probabilistic value of the claims of the parties – conducted in the shadow of authoritative judicial determination of their value – the proceedings are likely instead to descend, as in this case, to negotiations based solely on the leverage of threats to disenfranchise even well-founded claims based on a perceived failure to cooperate with the interests and plans of the settling parties.

This Court for decades has led the way in denouncing the use of the bankruptcy process to implement private arrangements that elevate the interests of institutional insiders over their pre-bankruptcy entitlements. Judicial enforcement of private "settlements" in that context is particularly pernicious because of the extraordinary leverage it provides against holdout creditors: ordinarily, the worst thing a claimant faces when it refuses to settle is the possibility that it will lose because its claims will be found meritless. In this context, by contrast, the holdout against a structured dismissal retains not even a chance to prove the merit of its claims.

ARGUMENT

I. Priority-Skipping Settlements Undermine the Predictability on Which Commercial Lending Markets Depend.

A. As petitioners explain in detail (Pet. Br. 8-10), the Bankruptcy Code implements a detailed and explicit ordering of priorities. Codified in Section 507 and related provisions,[2] that framework reflects two considered judgments. First, as a baseline, it leaves in place the priorities that creditors establish for themselves as a matter of state law. *E.g.*, Sections 510, 726, 1129, 1225, 1325. Second, it defines and codifies an explicit list of priority claims, departures from the pre-bankruptcy ordering that implement a variety of policies found by Congress to present "special circumstances or special need" adequate to justify those departures. Section 507(a)(1)-(10). *See* H.R. Rep. No. 95-595, at 186 (1977). Like the list of exceptions to the discharge considered in *Law v. Siegel*, 134 S. Ct. 1188 (2014), the "mind-numbingly detaile[d] enumeration" of those exceptions (134 S. Ct. at 1196)[3] underscores the impropriety of unmoored judicial departures from that framework. What is the point of enumerating the priorities so carefully if

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[2] For convenience, this brief refers to provisions in the current version of the Bankruptcy Code (Title 11 of the United States Code) by Section number only.

[3] The detail of the enumeration relates directly to the care with which Congress attends to the specific attributes of those provisions. *E.g.*, H.R. Rep. No. 95-595, *supra*, at 186-94 (justifying changes from pre-Code priority provisions).

they are important only in the cases in which all wish to respect them?

The context of this particular dispute obscures the disturbing ramifications of the legal doctrine on which the decision of the court of appeals rested. If a bankruptcy court is free to disregard the statutory priority provided to the petitioner employees in this case through a "structured dismissal," there is no reason to believe that the superior rights that secured creditors hold in bankruptcy will be any more secure. In this case, the disadvantaged creditors (the petitioner employees) may or may not have relied substantially, in their pre-bankruptcy activities, on the likely priority of their claims. *See* H.R. 95-595, *supra*, at 187 (discussing importance of "ensur[ing] that employees will not abandon a failing business for fear of not being paid").[4] But the balance sheets of the large businesses that dominate the Chapter 11 dockets of the bankruptcy courts are replete with multiple tiers of debt. In the context of that type of indebtedness, explicit and detailed pre-bankruptcy contractual arrangements regarding the priority and subordination of the various tiers of debt are routine.[5] It is crucial to the effectiveness of

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[4] In addition to the wage claims, petitioners also had claims under the federal WARN Act and New Jersey law. *See* Worker Adjustment and Retraining Notification (WARN) Act, 29 U.S.C. §§ 2101-2109; Millville Dallas Airmotive Plant Job Loss Notification Act, N.J. Stat. Ann. 34:21-1 to -7. *See* Pet. App. 37a, Pet. 9.

[5] The frequency of appellate litigation involving pre-bankruptcy intercreditor or subordination agreements provides compelling evidence of their frequent use. *See In re Coastal Broadcasting Systems, Inc.*, 570 Fed. Appx. 188 (CA3 2014);

those arrangements and the liquidity of the resulting obligations that the process in which those obligations are forcibly collected – almost invariably a bankruptcy proceeding – respects the priority scheme that those arrangements devise.[6]

The link between the bankruptcy's priority regime and pre-bankruptcy allocations of priority is foundational. As Judge Posner explains,

> The priority that lenders enjoy in bankruptcy over owners is a function of the difference in their relation to the enterprise. Lenders bear less risk

Contrarian Funds LLC v. Aretex LLC (*In re Westpoint Stevens, Inc.*), 600 F.3d 231 (CA2 2010); *SCR Joint Venture L.P. v. Warshawsky*, 559 F.3d 133 (CA2 2009); *Eastman Kodak Co. v. Atlanta Retail, Inc.* (*In re Atlanta Retail, Inc.*), 456 F.3d 1277 (CA11 2006); *Ketchikan Pulp Co. v. Foothill Capital Corp.*, 134 Fed. Appx. 114 (CA9 2005); *In re PWS Holding Corp.*, 228 F.3d 224 (CA3 2000); *Chemical Bank v. First Trust* (*In re Southeast Banking Corp.*), 156 F.3d 1114 (CA11 1998); *Simas v. Western Distribution Centers* (*In re Western Distribution Centers*), 36 F.3d 1104 (CA9 1994); *Robinson v. Howard Bank* (*In re Kors, Inc.*), 819 F.2d 19 (CA2 1987).

[6] The argument does not undermine the authority of secured creditors to dispose as they wish of proceeds of their collateral or distributions with respect to their secured claims. The practice of "tipping" (or "gifting") in which undersecured secured creditors – holding liens that effectively cover the entire estate – forgo a portion of their own recovery so that one or more lower priority classes of claims or interests may realize small recoveries merely respects the right of those creditors to dispose of their property as they will. The court of appeals decided this case, by contrast, on the premise that the funds at issue were unencumbered assets of the estate. *See* Pet. Br. 37 n.7.

> because they have the first claim on the borrower's assets in the event of insolvency, and they pay for this by surrendering all upside risk to the borrower's owners (who in that way are compensated for bearing more downside risk than the creditors). The creditors' priority in bankruptcy mirrors the contractual allocation of risk and reward between creditors and shareholders.

Commodity Futures Trading Comm'n v. Lake Shore Asset Mgm't Ltd., 646 F.3d 401, 408 (CA7 2011) (citing Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 Yale L.J. 857 (1982)).

The Code establishes a regime under which groups of creditors can establish priorities secure in the knowledge that a resolution of the borrower's affairs in a bankruptcy proceeding will respect those priorities in allocating the available assets of the borrower, subject only to the limited claims afforded priority under Section 507, which rarely are large enough to have structural significance in the balance sheet of large business enterprises. It is one thing for creditors to compromise their claims, accepting less than their entitlements in return for the agreement of others to compromise their claims as well; the Chapter 11 process could hardly survive without voluntary resolution of most large- company proceedings. But a court is not implementing a "settlement" when it uses a structured dismissal to skip over the claims of non-consenting creditors.

Validation of priority-skipping dismissals as a tool for evading the statutory priorities exposes creditors to an entirely new and not readily priced risk that opposing parties in a Chapter 11 proceeding will agree upon a dismissal arrangement that subverts the pre-bankruptcy disposition of priority.

Almost forty years ago this Court recognized Congress's decision to craft a bankruptcy system that "has generally left the determination of property rights in the assets of a bankrupt's estate to state law," *Butner v. United States*, 440 U.S. 48, 54 (1979). Thus, "[b]ankruptcy is basically a procedural form designed to provide a collective proceeding for the sorting out of non-bankruptcy entitlements." *Worcester v. Rosner* (*In re Worcester*), 811 F.2d 1224, 1228 (CA9 1987) (citing Jackson, *supra*; Douglas Baird & Thomas H. Jackson, *Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U. Chi. L. Rev. 97 (1984)). In the particular context of a failing business, "[a] corporate reorganization is fundamentally a process of dividing assets among the firm's creditors on the day of bankruptcy. * * * * Existing claims are divided according to the contractual rights of the claimants. If there are not enough assets to go around, some claims may be written down or extinguished." *Boston & Maine Corp. v. Chicago Pacific Corp.*, 785 F.2d 562, 565 (CA7 1986) (citing Jackson, supra).

B. Replication of pre-bankruptcy priorities in the federal system is more than a historical accident. On the contrary, it serves important systemic interests. For one thing, absent some articulable justification persuasive to Congress, "there is no reason why [creditor priorities] should be analyzed differently because an interested party is involved in a bankruptcy proceeding," *Butner*, *supra*, 440 U.S. at 55; see *Lewis v. Manufacturers Nat'l Bank*, 364 U.S. 603, 609 (1961) (deprecating rules that provide "a windfall merely by reason of the happenstance of bankruptcy"); *Patterson v. Shumate*, 504 U.S. 753, 764 (1992) (same). Moreover, because it ensures the continual validity of traditional bargained for priorities, "[u]niform treatment * * * by both state and federal courts within a State serves to reduce uncertainty," *Butner*, *supra*, 440 U.S. at 55.

It is difficult to overstate the centrality to well-functioning credit markets of an insolvency system's transparent replication of pre-bankruptcy priorities. Suffice it to say that it is a key feature on which international institutions insist in the guidance they offer developing nations. For example, the World Bank has developed (and repeatedly updated) a set of *Principles for Effective Insolvency and Creditor/Debtor Rights Systems* (2016) [hereinafter *World Bank Principles*]. Those principles reflect the view that

> [w]ell-designed legal and regulatory frameworks with respect to insolvency and creditor/debtor rights (ICR) facilitate the extension of credit and enable private sector development. The availability of credit is a key driver of economic activity, innovation and

> growth. * * * * Overall, the transparency and efficiency of ICR systems have a direct impact on the allocation of credit risk and risk management in the financial sector, and consequently also influence access to credit and its cost.

World Bank Principles, *supra*, at ii. Nor is that view wholly anecdotal. Rather, the World Bank's analysis of available data documents the association of effective insolvency regimes with a lower cost of credit, increased availability of credit, and increased returns to creditors.[7]

The centerpiece of the *World Bank Principles* is a set of "benchmarks" that reflect "internationally-recognized best practices in the design of ICR systems." *Id*. at ii. With regard to the legal framework for insolvency, the Principles emphasize as one of the "Key Objectives and Policies" that insolvency systems should "[r]ecognize existing creditor rights and respect the priority of claims with a predictable and established process." *Id*. at 20. By routinizing unexplained departures from pre-bankruptcy priorities – which is to say departures that are neither transparent nor predictable – the priority-skipping dismissal directly contradicts that

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[7] *See* Debt Resolution & Business Exit Team, World Bank Group Trade & Competitiveness Global Practice, *Viewpoint: Debt Resolution and Business Exit* 1-5 (July 2014), *available at* https://www.wbginvestmentclimate.org/advisory-services/regulatory-simplification/debt-resolution-and-business-exit/viewpoint-debt-resolution-and-business-exit.cfm (last visited August 10, 2016).

norm. It would be sadly ironic were this Court to confirm a power, implementing "untethered notions of what might be good judicial policy," *Whitmore v. Arkansas*, 495 U.S. 149, 161 (1990), to contravene the norms that our Nation presses so insistently on the policymakers of less-developed nations.

II. Priority-Skipping Settlements Disrupt the Bankruptcy Process by Diverting the Focus from Prompt Estimation of the Claims of Creditors to the Compulsion of Consent by Threatened Diversions of Value.

The systemic harms associated with the validation of priority-skipping dismissals extend well beyond the external pre-bankruptcy credit markets. They also threaten a corrosive degradation of the bankruptcy process itself. On that point, the lessons from history are telling, as dismissals structured to elevate the interests of select creditors presage the repetition of a pattern of receivership abuse brought to an end by this Court's intervention almost eighty years ago in *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939).[8]

The *Case* Court considered a common practice of the time, a reorganization of a failed business in which the original shareholders retained an interest in the firm despite the failure of the proceeding to repay general creditors in full. Conventional wisdom

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[8] *See generally* Douglas G. Baird & Robert K. Rasmussen, Boyd*'s Legacy and Blackstone's Ghost*, 1999 Sup. Ct. Rev. 393 (comprehensive discussion of *Case* and its predecessors).

at the time regarded that process as unexceptional.[9] The Court, however, rejected the arrangement out of hand, explaining that the requirement of "fair and equitable" plans foreclosed any plan that did not absolutely respect the state-law priority of creditors and shareholders. Thus, the Court noted the "familiar rule that the stockholder's interest in the property is subordinate to the rights of creditors. First, of secured, and then, of unsecured creditors." *Case*, *supra*, 308 U.S. at 116 (citation and internal quotation marks omitted). More expansively, the Court explained that "any arrangement of the parties by which the subordinate rights and interests of the stockholders are attempted to be secured at the expense of the prior rights of either class of creditors comes within judicial denunciation." *Id.* (citation and internal quotation marks omitted).

Case's categorical rejection of the insider collusion that had dominated reorganization practice in the preceding decades is a landmark in judicial insistence that the bankruptcy process respect pre-contractual priorities. *See* John D. Ayer, *Rethinking Absolute Priority After* Ahlers, 87 Mich. L. Rev. 963, 1022-23 (1989) (describing the "central problem" of "insider collusion" and *Case*'s eradication of it). To the extent statutory enactments left any doubt about

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[9] *E.g.*, Henry J. Friendly, *Some Comments on the Corporate Reorganization Act*, 48 Harv. L. Rev. 39, 75-76 (1934) (describing the propriety of such an arrangement "as definitely settled"); James C. Bonbright & Milton M. Bergerman, *Two Rival Theories of the Priority Rights of Security Holders in a Corporate Reorganization*, 28 Colum. L. Rev. 127, 132 (1928).

the matter, Congress directly incorporated the doctrinal analysis of *Case* into the Bankruptcy Code adopted in 1978. *See* Section 1129; H.R. Rep. No. 95-595, *supra*, at 413-14 (House Report discussing intent to codify obligation to pay dissenting creditors "in full before any junior class may share under the plan"). And each time this issue has returned to this Court, the Court's subsequent pronouncements have only served to extend and confirm that approach. *E.g.*, *Bank of America Nat'l Trust & Savings Ass'n v. 203 North LaSalle Street Partnership*, 526 U.S. 434 (1999).

In practical effect, the dismissal order validated in this case is nothing but an updated example of the collusive departures from priority that *Case* and Section 1129 condemn. In this case, the institutional bankruptcy players – the debtor, its sponsor (which was also its remaining secured creditor), and the official committee of unsecured creditors – reached an agreement that paid millions of dollars to the general unsecured creditors (represented by the committee), millions of dollars to administrative claimants (conspicuously including the attorneys' fees of the committee), yet not one penny to the priority claims of the employees, apparently because of pique at the employees' refusal to dismiss lawsuits against related entities not in the bankruptcy proceeding. *See* Pet. App. 4a-6a; Pet. 11. Just as in the pre-*Case* receiverships, those players reached an agreement that they should divide the available assets among themselves, leaving unpaid the claims of those without the clout, relationships, or flexibility to earn seats at the bargaining table.

The use of a dismissal order to implement the types of partial settlement agreements presented here is particularly pernicious because it leaves the court's disposition of the parties' disputed claims both unexplained and unreviewable. Because the standard under which a bankruptcy court approves such an agreement has nothing to do with the merits of the adversely affected claims – but turns solely on vague notions of adequate "grounds to justify [the] deviation," Pet. App. 21a (alteration in original) – the bankruptcy court's approval of the order leaves nothing of record to explain either the validation of the claims of the inferior creditors receiving funds under the settlement or the rejection of the claims of the prior creditors left unpaid by the settlement. So, for example, reviewing courts have no record of the bankruptcy court's view as to the priority or merit of the vitiated claims of the petitioner employees. In much the same way, the dismissal order offers no assessment of the likelihood that the general unsecured creditors would have prevailed on the claims for which the settlement paid them such a large share of the borrower's assets.

It is similarly problematic that the dismissal process elevates the leverage in favor of settlement beyond any reasonable bounds. Ordinarily, when parties (or a trial court) press for settlement, the party resisting settlement can bargain by balancing the settlement offer against the likely outcome if the reluctant settlor insists on full adjudication; the worst consequence of a refusal to settle is an adjudication on the merits of the claims of the holdout claimant. With structured dismissal as an option, however, opposing parties (or the bankruptcy court) can press for settlement backed by the threat that a refusal to settle will be punished by the denial of any recovery at all, even for undeniably meritorious claims. Whatever the precise bounds of the "equitable" principles implicit in the Code (*Bank of Marin v. England*, 385 U.S. 99, 103 (1966)), such a process cannot be within them.

It is particularly inappropriate to repose such a broad grant of unreviewable discretion in courts that are not constituted under Article III. *See Wellness Int'l Network v. Sharif*, 135 S. Ct. 1932, 1945 (2015) (tolerating consent as a basis of adjudication of common-law matters before bankruptcy judges because the authority of the bankruptcy courts "is limited to a narrow class of common law claims as an incident to the bankruptcy courts' primary, and unchallenged, adjudicative function").[10] It only exacerbates the risk posed by such an unreviewable grant of discretion that other wholly independent developments have cut off appellate review of a rapidly growing share of the adjudicative output of business bankruptcies. *See Bullard v. Blue Hills Bank*, 135 S. Ct. 1686 (2015) (no appeals of order refusing to confirm a plan); *In re Tribune Media Co.*, 799 F.3d 272 (CA3 2015) (broad application of doctrine of equitable mootness to prevent appellate review of order confirming plan); *R^2 Invs., LDC v. Charter Communications, Inc.* (*In re*

[10] *See also* Douglas G. Baird & Anthony J. Casey, *Bankruptcy Step Zero*, 2012 S. Ct. Rev. 203 (linking lack of Article III status with Court's reluctance to recognize broad discretion of bankruptcy courts).

Charter Communications), 691 F.3d 476 (CA2 2012) (same).

CONCLUSION

The decision of the court of appeals validates a process under which parties involved in a reorganization proceeding can agree among themselves on the appropriate distribution of the assets of the failed business without any regard for the priority or merit of the claims of dissenters. There is no place for such a process in the Bankruptcy Code or in the courts that administer it. The negotiation process on which Chapter 11 depends operates against a backdrop of reviewable judicial determination of the entitlements that the parties hold on the merits, not the vagaries of their raw negotiating leverage in any particular case. We respectfully submit that the Court should reverse the decisions of the court of appeals.

Respectfully submitted,

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September 2016