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 COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF OF *AMICI CURIAE* NATIONAL EMPLOYMENT LAW PROJECT, NATIONAL CONSUMERS LEAGUE, LEGAL AID SOCIETY AND ASIAN AMERICAN LEGAL DEFENSE AND EDUCATION FUND IN SUPPORT OF PETITIONERS

ADDITIONAL COUNSEL
LISTED OVERLEAF

SIMON A. STEEL
Counsel of Record
JULIE A. WADDELL
C. JARRETT DIETERLE
HARKINS CUNNINGHAM LLP
1700 K Street, NW, Ste. 400
Washington, DC 20006
(202) 973-7600
ssteel@harkinscunningham.com

SEPTEMBER 2, 2016

ADDITIONAL COUNSEL FOR *AMICI CURIAE*

CATHERINE K. RUCKELSHAUS
NATIONAL EMPLOYMENT LAW PROJECT
75 Maiden Lane, Ste. 601
New York, NY 10038
(646) 693-8221
cruckelshaus@nelp.org

SALLY GREENBERG
NATIONAL CONSUMERS LEAGUE
1701 K Street, NW, Ste. 1200
Washington, DC 20006
(202) 835-3323
sallyg@nclnet.org

SEYMOUR W. JAMES, JR.
ADRIENE L. HOLDER
KAREN CACACE
LAURA RUSSELL
RICHARD BLUM
DIANE JOHNSTON
THE LEGAL AID SOCIETY
199 Water Street
New York, NY 10038
(212) 577-3648
rblum@legal-aid.org

KENNETH KIMERLING
ASIAN AMERICAN LEGAL DEFENSE AND EDUCATION FUND
99 Hudson St, 12th Fl.
New York, NY 10013
(212) 966 5932
kkimerling@aaldef.org

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

CASES

STATUTES, LEGISLATIVE HISTORY, AND RULES

OTHER AUTHORITIES

INTERESTS OF *AMICI CURIAE*[1]

The *amici curiae* filing this brief are non-profit legal and public interest advocacy organizations united by their concern that the decision below will enable corporate debtors and creditors to evade the priority scheme enacted by Congress in the Bankruptcy Code, making it more difficult and expensive, if not impossible, for small creditors, such as employees with unpaid wages and benefits and customers with unrefunded deposits, to recover from corporate debtors in bankruptcy. It is a*mici*'s experience that evasion of obligations to employees and customers is a common and growing motivation for, and strategy in, corporate bankruptcies. The Bankruptcy Code's priority scheme is an essential protection against wage theft and other such abuses, and the decision below threatens to significantly undermine that protection, to the detriment of the clients and interests *amici* represent.

The National Employment Law Project ("NELP") is a legal organization with over 45 years of experience advocating on behalf of low-wage and unemployed workers. NELP has a long-standing commitment to the enforcement of workplace rights and has litigated and participated as an *amicus* in numerous cases addressing workers' rights to wage

---

[1] Pursuant to this Court's Rule 37.3(a), all parties submitted letters to the Clerk granting blanket consent to *amicus curiae* briefs. Pursuant to Rule 37.6, *amici* affirm that no counsel for a party authored this brief in whole or in part, and that no person other than *amici* or their counsel contributed any money to fund its preparation or submission.

and benefits payments. NELP has been particularly active in documenting and combatting the growing problem of wage theft and the dire impact that workers' failure to collect unpaid wages can have on the economic security of workers' families.

National Consumers League ("NCL") is the Nation's oldest consumer and worker advocacy organization. Its mission is to protect and promote social and economic justice for consumers and workers. NCL has been a strong advocate for low wage workers, workplace rights, and minimum wage increases, and has fought against the epidemic of wage theft. NCL advocates on behalf of low wage workers and represents their perspective before Congress, city councils, administrative agencies and the courts.

The Legal Aid Society is the oldest and largest provider of legal assistance to low-income families and individuals in the United States. The Society's Civil Practice operates trial offices in all five boroughs of New York City, providing comprehensive legal assistance in housing, public assistance, and other civil areas of primary concern to low-income clients. The Society's Employment Law Unit represents low-wage workers in employment-related matters such as unemployment insurance hearings, claims for unpaid wages, and claims of discrimination. The Unit conducts litigation, outreach and advocacy efforts on behalf of clients designed to assist the most vulnerable workers in New York City, among them, workers whose wages are stolen by unscrupulous employers. All too often, those employers file for bankruptcy protection as a strategic weapon to avoid paying their workers the money they owe. The workers rely on the

Bankruptcy Code's priority for wages to ensure successful resolutions of their claims as creditors. The Society's Consumer Law Unit provides representation, advocacy, and outreach to low-income consumers in a wide range of consumer protection matters, including credit cards, student and personal loans, debt collection, auto fraud, medical debts, and personal bankruptcy. Particularly in the areas of automobile transactions and for-profit schools, its consumer clients depend on the Code's priorities to ensure the fair treatment of their claims.

The Asian American Legal Defense and Education Fund ("AALDEF"), founded in 1974, is a national organization that protects and promotes the civil rights of Asian Americans. By combining litigation, advocacy, education, and organizing, AALDEF works with Asian American communities across the country to secure human rights for all. From its inception, AALDEF has sought to insure that the lawfully earned wages of immigrant Asian workers are paid. In many of AALDEF's lawsuits on behalf of these workers, the employers file bankruptcy. These workers are low wage earners, often subject to wage theft, many of whom are unable to speak or read English. They therefore suffer grave difficulties attempting to protect their interest in bankruptcy proceedings – difficulties that will be greatly exacerbated by the uncertainty, complications and impairment of their priority creditor rights and bargaining power effected by the Third Circuit's decision.

SUMMARY OF ARGUMENT

This case involves the legality of a structured dismissal of a Chapter 11 bankruptcy case whereby the bankruptcy court (i) approves a settlement of a claim held by the estate, (ii) pursuant to the settlement, authorizes the distribution of the proceeds (which constitute all the assets of the estate) to creditors in a manner contrary to the priorities set forth in Section 507(a) of the Bankruptcy Code, and (iii) dismisses the case. *See* Pet. App. 55a.[2]

Nothing in the Bankruptcy Code authorizes such an order, this Court has never upheld a bankruptcy court order contrary to the Section 507(a) priorities, and the Fifth Circuit has held that such orders are *per se* unlawful. However, in the decision below, the Third Circuit upheld a structured dismissal order that authorized the distribution of the estate's remaining assets to general unsecured creditors, to the total exclusion of the debtor's employees, whose claims for unpaid employment compensation were entitled to statutory priority under 11 U.S.C. § 507(a)(4) and (5). In doing so, it set a precedent for judicial nullification of essential protections Congress has mandated for employees and other small creditors since the nineteenth century.

The issue at stake in this case is perhaps narrow, but very important. It is undisputed that bankruptcy courts have the power to approve settlements of estate causes of action, and that, subject to "fair and equitable" review, settlements are

---

[2] *Amici* respectfully refer the Court to petitioners' Statement of the Case.

generally favored. It is also undisputed that rights to priority can be given up by agreement of the creditors who possess those rights – agreement that was absent in this case. And the legality of structured dismissal *per se* is not at issue.

What is, however, disputed is whether a bankruptcy court can issue a structured dismissal order that, as one of its terms, expressly strips non-consenting creditors of their priority rights. In asserting such power, the courts below usurped Congress's prerogative to assign priorities among creditors, thereby undermining vital protections Congress has mandated for employees, consumers and other small creditors.

The Third Circuit suggested that its order was premised on exceptional circumstances, and that bankruptcy judges' discretion could be entrusted to ensure fair results. Pet. App. 23a. Even apart from the fact that that rationale ignores Congress's conclusive determination, via the Code's priority scheme, of what is "fair," it reflects an unrealistic perspective on the bankruptcy process.

The reality is that, for several reasons, the Third Circuit's decision threatens, and indeed is already having, a broad detrimental impact on employees, consumers and other priority creditors. *First*, while it may manifest in various ways, the motivation for one or another party to a bankruptcy proceeding to defeat non-consenting priority creditors' rights, and for other parties to join in a "settlement" that can be presented to the bankruptcy court to achieve that result, is omnipresent. Collusion between corporate debtors and creditors is the fundamental ill Congress created small-creditor priorities to guard against; "settlements" between those same parties are not exceptional circumstances that justify overriding the priority. *Second*, sophisticated corporate creditors and debtors typically have the opportunity, the information, and the resources necessary to frame evidence and "settlements" in a way that small creditors are powerless to resist. Given those advantages, they can readily manufacture a purportedly exceptional record which may prevent even the most conscientious bankruptcy judge from accurately determining what is, in fact, "fair and equitable." *Third*, reliance on the good judgment of bankruptcy judges will be to no avail in the many cases that lie below the tip of the iceberg – the cases in which the threat of a priority-skipping structured dismissal created by the Third Circuit's decision induces priority creditors to surrender or settle on unfavorable terms.

Moreover, the Third Circuit's rule is not, as it suggested, necessary to avoid a "nihilistic" outcome whereby no creditors get paid. *See* Pet. App. 23a. To be sure, settlement is crucial to achieving mutually beneficial results in bankruptcy. But a true settlement is one to which all parties whose rights are compromised consent. Congress has written flexibility into the Bankruptcy Code: priority creditors can agree to waive their priority rights in return for some payment in a true settlement that will make all parties better off. The additional discretion asserted by the courts below, to not merely approve a settlement but to judicially sanction cutting one of the parties out of the deal, is inconsistent both with the

Code and with the certainty of legal rights on which efficient settlement negotiations rely.

ARGUMENT

I. SECTION 507 PRIORITIES ARE AN ESSENTIAL, MANDATORY PART OF CONGRESS'S SCHEME, AND CRITICAL TO PROTECT EMPLOYEES, CONSUMERS AND OTHER SMALL CREDITORS

Since at least 1841, in successive bankruptcy codes, Congress has set the essential terms of the social compact that is bankruptcy: Congress grants debtors protection against creditors, but on the condition that they distribute their assets equitably, in accordance with Congress's priorities. The key to that compact now lies in Section 507 of the Code.

Section 507(a) lists in descending order of priority ten categories of priority claims, all of which have priority over claims of general unsecured creditors. This case directly involves categories 4 and 5 – employees of the debtor with unpaid claims for employment compensation, including wages, severance pay and benefits. *See* 11 U.S.C. § 507(a)(4) and (5). But the question presented is equally applicable to the various other types of claim to which Congress has assigned priority in Section 507, including claims of farmers and fishermen, *see* 11 U.S.C. § 507(a)(6), consumers and renters, *see* 11 U.S.C. § 507(a)(7), and certain governmental units, *see* 11 U.S.C. § 507(a)(8). In Section 507, Congress explicitly "specifie[d] the kinds of claims that are entitled to priority in distribution, and the order of the priority." H.R. Rep. No. 95-595, at 357-58 (1978), *as* *reprinted in* 1978 U.S.C.C.A.N. 5963. And in Section 103(a), Congress instructed that Section 507 shall apply regardless of whether a case is proceeding under chapter 7, chapter 11, chapter 12, or chapter 13 of the Code. 11 U.S.C. § 103(a).

Section 507's priority scheme is mandatory; it is not subject to a bankruptcy judge's discretion. *See, e.g., United States v. Reorganized CF&I Fabricators of Utah, Inc.,* 518 U.S. 213, 229 (1996); *United States v. Noland*, 517 U.S. 535 (1996). Where Congress "intended to alter the priority scheme established in section 507, it has done so explicitly." *In re Roth Am., Inc.,* 975 F.2d 949, 956 (3d Cir. 1992); *see* 11 U.S.C. §§ 364(c), 510, 724(b), 726(a) and (b), 901, 1129(a)(8)(A), 1222(a)(2)(B), 1322(a)(2). No such statutory exception is at issue in this case.

The employment compensation priority, in particular, has a long history and compelling rationales. The principle that wage earners should receive priority status among creditors has its origin in the Bankruptcy Act of 1841, in which Congress created three categories of priority, one of which was wages due to "operatives" (*i.e.*, employees). *See* C. Scott Pryor, *The Missing Piece of the Puzzle: Perspectives on the Wage Priority in Bankruptcy*, 16 AM. BANKR. INST. L. REV. 121, 125-26 (2008). Since that time, the wage priority has been a constant in all subsequent iterations of U.S. bankruptcy law. *See id.* at 128-41.

Courts and commentators have recognized at least three reasons why the wage priority and other small creditor priorities in Section 507(a) are critically important. First, as this Court explained over a century ago, wage earners merit priority status because they "necessarily depend[] upon their daily labor" for subsistence. *Guarantee Title & Trust Co. v. Title Guar. & Sur. Co.*, 224 U.S. 152, 160 (1912); *see also Blessing v. Blanchard*, 223 F. 35, 37 (9th Cir. 1915) ("Priority of payment was intended for the benefit only of those who are dependent upon their wages … [and therefore] would be in need of such protection."); *In re Nw. Eng'g Co.*, 863 F.2d 1313, 1318 (7th Cir. 1988) ("Workers do not have diversified portfolios of employment. One business failure is all they care about.").[3]

Second, banks and other corporate creditors typically become creditors through a conscious and voluntary process in which they evaluate credit risk, decide whether to demand security (thereby obtaining a better position than priority creditors in the event of the debtor's insolvency), and charge interest that reflects the credit risk. In contrast, employees and other Section 507(a) priority creditors are not in the business of "extending credit by waiting for their paychecks," 4 *Collier on Bankruptcy* ¶ 507.06 (16th ed.

---

[3] The wage priority also serves an important function for debtor employers, to the benefit of all involved. Assuring employees of priority status for their wages increases the probability that they will stay to participate in a reorganization effort. *See* Daniel Keating, *The Fruits of Labor: Worker Priorities in Bankruptcy*, 35 ARIZ. L. REV. 905, 907 (1993) ("[I]n a case where the employer is attempting to reorganize in bankruptcy, the employees will almost always be crucial to the success of such an undertaking."); *Nw. Eng'g Co.*, 863 F.2d at 1315 ("If employees were treated in all respects as unsecured creditors, they would be inclined to desert a leaky ship, speeding up the firm's collapse").

2015),[4] and generally lack both the information necessary to anticipate, and the opportunity to protect themselves against, the insolvency of those with whom they deal. In the present case, for example, petitioner employees had no prior notice of their employer's bankruptcy and the loss of their livelihoods.

Third, absent strong and reliable priority protection, employees, consumers and other small creditors are apt to lose out to sophisticated corporate debtors and creditors in the onerous and arcane process of bankruptcy proceedings. Debtor corporations and corporate general unsecured creditors often have substantial sums at stake, large legal budgets, the financial ability to sustain protracted, complex litigation, and the opportunity to anticipate and negotiate around bankruptcy developments. In contrast, workers and consumers typically have smaller claims,[5] smaller budgets, and far less (if any) ability to sustain complex litigation

---

[4] Federal labor law requires that wages be paid promptly. *See, e.g.,* 29 C.F.R. § 778.106 ("Payment [of overtime pay] may not be delayed for a period longer than is reasonably necessary for the employer to compute and arrange for payment of the amount due and in no event may payment be delayed beyond the next payday after such computation can be made.").

[5] The Code itself limits the size of claims for which priority can be claimed: individual employees enjoy priority for their claims only up to a limit of $12,850, 11 U.S.C. § 507(a)(4), and individual consumers and renters only up to $2,850, 11 U.S.C. § 507(a)(7). In giving priority to such small claims, Congress plainly intended that their assertion should be a simple, low-cost process – not that it would require years of onerous litigation entailing legal fees far in excess of the amounts at stake.

and negotiations. *See, e.g.,* Paul G. Kauper, *Insolvency Statutes Preferring Wages Due Employees*, 30 MICH. L. REV. 504, 507-08 (1931) (discussing factors that impair employees' bargaining power in bankruptcy context, including inability to ascertain employer's credit, limited financial resources, dependency on income from employer, and lack of security interest).[6]

For more than a century, Congress and the courts have recognized that to ensure fair treatment of employees and other small creditors given these realities, bankruptcy priorities must be absolute. In the nineteenth century, the courts adopted the absolute priority rule (that there can be no exceptions to priority, absent consent, in a plan of reorganization) "to preclude the practice . . . of 'squeezing out' intermediate unsecured creditors through collusion between secured creditors and stockholders (who were often the same people)." *In re Wabash Valley Power Ass'n*, 72 F.3d 1305, 1314 (7th Cir. 1995). That is precisely the concern raised by the structured dismissal in this case. Congress then codified that rule, first implicitly (via the requirement that a reorganization plan be "fair and equitable") in the 1898 Bankruptcy Act, *see Case v. Los Angeles Lumber*

---

[6] The present case is uncommon insofar as, by virtue of the efforts of contingency and *pro bono* counsel, the petitioner employees have been able to sustain eight years of complex litigation seeking to recover back pay to which they were statutorily entitled. But it is typical insofar as they have still received no payment whatsoever in respect of their undisputed rights to employment compensation. *Amici* provide *pro bono* services, but the vast majority of employees and other small priority creditors lack such resources and are compelled to abandon their claims or settle them on highly unfavorable terms.

Prods. Co., 308 U.S. 106, 114-17 (1939), and later explicitly in 11 U.S.C. § 1129(b)(2).

The Third Circuit's decision opens a loophole in that rule, holding that while priority is an absolute constraint against approving a reorganization plan to which priority creditors do not consent, it is merely a factor (albeit an important one) to consider in approving a structured dismissal to which priority creditors do not consent. It does so notwithstanding that a structured dismissal order may be no less complete and effective in determining the rights of creditors than a plan confirmation order. This bankruptcy loophole creates a new opportunity for various abuses, including wage theft – employers failing to pay employees compensation to which they are entitled, without effective accountability – at a time when, as U.S. Department of Labor and independent studies collected by NELP reflect, wage theft has reached epidemic proportions nationwide.[7] As a result, many thousands of additional employees could be subjected to bankruptcy court orders depriving them of what they have earned even when funds are received into their employer's estate that could and should be used to pay them. Moreover, the Third Circuit's decision may invite unscrupulous

---

[7] *See, e.g.,* NELP, *Winning Wage Justice: A Summary of Research on Wage and Hour Violations in the United States* (July 2013), http://www.nelp.org/content/uploads/2015/03/WinningWageJusticeSummaryofResearchonWageTheft.pdf; U.S. Dep't of Labor, *Workers Face Millions in Unpaid Wages in Southern California Garment Industry* (Nov. 6, 2014), http://www.dol.gov/opa/media/press/whd/WHD20142047.htm; U.S. Dep't of Labor, *1999-2000 Report on Initiatives* (Feb. 2001), http://nelp.3cdn.net/a5c00e8d7415a905dd_o4m6ikkkt.pdf.

employers who have not met their basic legal obligations under, for example, minimum wage law, to misuse bankruptcy proceedings to continue to evade those obligations.

The same risks exist for consumers and other small creditors. Corporations that defraud consumers frequently file for bankruptcy, and when they do, they have every incentive to avoid repaying the deposits of dissatisfied consumers, with whom corporate insiders expect no future business relationship, while favoring corporate insiders and general unsecured creditors who could be vital partners for their next business. Like employees, consumers depend on the Code's priority scheme for their bargaining power.[8] The 11

---

[8] Congress added protection for consumer deposits, now codified at 11 U.S.C. § 507(a)(7), to the Code in 1978. Bankruptcy Reform Act of 1978, Pub L. No. 95-598, § 507(a)(5), 92 Stat 2549. As the House Report on that legislation explained:

> A consumer that pays money on a lay-away plan or as a deposit on merchandise, or that buys a service contract or a contract for lessons or a gym membership, is a general unsecured creditor of the business to which he has given money. Very few consumers are aware of their status as general unsecured creditors. If the merchant involved files under the bankruptcy laws, the consumer is usually left holding the bag. Though he assumed his deposit was tantamount to a trust fund, he gets nothing from the estate of the debtor, because the assets available provide little return to unsecured creditors. Because of his ignorance and his inability to bargain with a retail merchant, [the consumer] is unable to do a credit investigation or obtain special terms from the merchant, as a true creditor may do.

H.R. Rep. No. 95-595, at 188 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 6148-49.

U.S.C. § 507(a)(7) priority plays a vital role in protecting the rights of a wide range of consumers who have paid for services or products never delivered, including students,[9] home buyers and renters,[10] and retail customers.[11]

By relegating their priorities from a hard-and-fast right to a factor (albeit the primary factor) in a bankruptcy judge's discretion to approve a structured dismissal over their objection, the Third Circuit's decision deprives small creditors of the one real protection and the only leverage they have in bankruptcy proceedings. They already suffer many disadvantages in those proceeding. Tilting the playing field further in the favor of large, sophisticated corporate debtors and creditors is neither fair and equitable, nor consistent with the Code.

II. THE DECISION BELOW VIOLATES THE CODE AND WOULD DRAMATICALLY UNDERMINE THOSE ESSENTIAL PROTECTIONS

This Court has never upheld a bankruptcy court order that authorizes distribution of estate

---

[9] *See, e.g., In re Longo*, 144 B.R. 305 (Bankr. D. Md. 1992) (student deposits made to debtor vocational school entitled to priority status).

[10] *See, e.g., In re James R. Corbitt Co.,* 48 B.R. 937 (Bankr. E.D. Va. 1985) (couple that entered contract to purchase home entitled to two priority claims); *In re Trenton Ridge Investors, LLC*, 461 B.R. 440 (Bankr. S.D. Ohio 2011) (tenants with security deposit claims are entitled to priority status and thus not similarly situated to creditors with general unsecured claims).

[11] *See, e.g., In re P.J. Nee Co.*, 36 B.R. 609 (Bankr. D. Md. 1983) (customers of debtor furniture store who had made deposits and payments in full were entitled to priority status).

assets in a manner contrary to the priorities set forth in the Code (absent consent of the creditors whose priority rights are at issue). The Fifth Circuit has rightly held that a structured dismissal order with that effect is unlawful. *See In re AWECO, Inc.*, 725 F.2d 293, 298 (5th Cir. 1984) (holding that a bankruptcy court may approve a settlement only if it is "fair and equitable," with "fair and equitable" being "terms of art" meaning that senior interests are entitled to absolute priority over junior interests) (citing *SEC v. American Trailer Rentals Co.*, 379 U.S. 594 (1965)). But, in the decision below, the Third Circuit upheld a structured dismissal order that expressly distributed assets of the estate to general unsecured creditors over the objections of priority creditors, Jevic's truck driver employees.

The panel majority below purported to recognize an exception to bankruptcy priority in the context of a structured dismissal order, one that it asserted was "likely to be justified only rarely." Pet. App. 23a. It justified that exception on the basis that overriding employees' priority rights in an order effectuating a settlement to which those employees were not party was the "least bad alternative" in the circumstances. Pet. App. 21a. That justification, in turn, was based on the bankruptcy court's conclusions that the only way to secure any funds to pay unsecured creditors was by settling the estate's claim against Sun (the third party to which an allegedly fraudulent transfer of assets had been made), and that Sun would not settle unless the priority creditor employees' claims were entirely skipped. Pet. App. 21a-22a; *see also* Pet. App. 24a-25a (Scirica, J., dissenting).

The Third Circuit's exception is not one the courts are authorized to make. And in practice, despite the panel majority's claim that the supposed exception would be narrow, it is apt to become a regular feature, and an omnipresent threat, in bankruptcy proceedings, with grave implications for the rights of priority creditors generally.

A. The Third Circuit's Exception Violates the Code

The essential premise of the Third Circuit's ruling is that it is up to the bankruptcy court to determine whether a priority-skipping structured dismissal is the "least bad alternative." *See* Pet. App. 21a (deferring to the bankruptcy judge's view that the arrangement proposed by the corporate creditors and debtor and opposed by petitioner employees was the "least bad alternative"). But that mistakes the bankruptcy court's role.

When an otherwise lawful settlement involving an estate in bankruptcy is proposed, it is subject to bankruptcy court approval to ensure that the trustee in bankruptcy is meeting its fiduciary duties and the settlement is "fair and equitable." *See* Fed. R. Bankr. P. 9019; *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry v. Anderson*, 390 U.S. 414, 424 (1968). The Third Circuit purported to apply that standard, *see* Pet. App. 11a, and, by a 2-1 majority, found it to be met, *see id.* at 21a-23a. But nothing in the Bankruptcy Code or the Bankruptcy Rules authorizes a bankruptcy court to sanctify otherwise unlawful settlements or coercive arrangements that go beyond the scope of a settlement. A priority-skipping structured dismissal is not a lawful, consensual settlement: it entails a court order depriving unconsenting priority creditors of their substantive rights to priority.

Priority rules apply in all cases under the Bankruptcy Code, 11 U.S.C. § 103(a), subject only to specific, enumerated exceptions, *see, e.g., In re Roth Am.,* 975 F.2d at 956. The issue raised by the Third Circuit's decision – the relationship between priority rules and settlements – is specifically addressed by the Code: priorities can be overridden by a settlement *if* the class of creditors losing the right to priority agrees. *See* 11 U.S.C. § 1129(a)(8)(A).

Without such agreement, there is no "settlement" properly encompassing the priority rights. To be sure, a debtor-in-possession can "settle" its claims against a corporate third party, but those two parties cannot "settle" the priority rights of employee creditors who are not party to that agreement. In this case, the unsecured creditors' committee (acting on behalf of the bankruptcy estate) settled the estate's fraudulent conveyance claim against a secured creditor, Sun. Subject to the court's approval, that settlement could properly resolve both the estate's fraudulent conveyance claim and the fraudulent conveyance claims of all creditors of the estate. But it could not resolve the separate issue of the priority rights of employee creditors not party to the agreement.[12] The only parties that could bargain

[12] For some limited purposes, an unsecured creditors' committee may represent and bargain on behalf of the subset of unsecured creditors that is the priority creditors. For example, absent a conflict over priorities, the interests of all (priority and non-priority) unsecured creditors may be aligned: to maximize the

away those rights under § 1129(a)(8)(A), the employee creditors themselves, did not do so. Thus, when the bankruptcy court acceded to Sun and the unsecured creditors' committee's request that it enter an order overriding the employee creditors' priority rights, it was not approving a "settlement" with respect to those priority rights; it was simply stripping them away in violation of the Code.

B. The Third Circuit's Decision Threatens to Have Broad Detrimental Effects on Employees, Consumers, and Other Priority Creditors Congress Sought to Protect

The Third Circuit purported to recognize an exception to priority that will be "justified only rarely," Pet. App. 23a, and perhaps only when a bankruptcy judge concludes that a priority-skipping structured dismissal is the "least bad alternative." Pet. App. 21a. For several reasons, however, its decision has the potential for wide-reaching effects of grave concern to *amici* and the priority creditors they represent.

First, the loophole opened by the Third Circuit's decision is one that many corporate debtors and unsecured creditors will be motivated to use. In this particular case, in the name of equity, the bankruptcy

---

estate's assets. However, a committee appointed to represent unsecured creditors as a whole clearly cannot adequately represent priority creditors insofar as their interests directly conflict with those of non-priority creditors, as they inevitably do with respect to priority-skipping. And in practice, given the limited subset of creditor claims that are entitled to statutory priority, unsecured creditors' committees are typically dominated by corporate general unsecured creditors with large claims and strong incentives to undermine the Code's priorities.

judge approved a "settlement" stripping non-consenting priority creditors of their statutory rights because the party against whom the estate settled its claim, Sun, insisted on doing so in order to impair their practical ability to petition the courts for relief on their separate WARN Act claim. It may be rare that an estate settles a claim with a third party – here, Sun – that has its own motive for stripping other claimants of their priority rights. But the other settlement proponent – the debtor-in-possession or, in this case, the unsecured creditors' committee – often has such a motive. Corporate insiders often have ongoing or prospective business relationships that incentivize them to structure settlements to favor each other, while ignoring the interests of priority creditors. In *amici*'s experience, many corporate bankruptcy cases involve a business plan of maximizing short-term profit for as long as possible by flouting employee and consumer rights, then declaring bankruptcy and moving on to a new business. Particularly in leveraged buyout contexts like *Jevic*, the same or affiliated real parties in interest often have multiple roles in negotiations – as Sun did here, as both a third party against whom the bankruptcy estate had a claim and a secured creditor. And, unsecured creditors' committees dominated by large corporate general unsecured creditors have an inherent motive to strip priority creditors of their priority rights.

There will, therefore, frequently be both motive and opportunity for corporate parties to condition their settlements on an order stripping unconsenting priority creditors of their rights if, as the Third Circuit holds, such orders are potentially available. There is, in short, nothing "*sui generis*" about this case that offers any assurance that the precedent set by the Third Circuit will not be widely used and manipulated to undermine priority creditors' rights. *See* Pet. App. 31a (Scirica, J., dissenting).

Second, a bankruptcy judge's discretion to determine whether a "settlement" is "fair and equitable," weighing priorities as a non-conclusive factor in accordance with the Third Circuit's decision, is an inadequate substitute for Congress's priority rule.[13] Bankruptcy judges may exercise their discretion with "Solomonic" wisdom (Pet. App. 22a) and in the interests of justice.[14] But they must necessarily do so based on the record presented to them. For precisely the reasons that underlie Congress's decision to protect small creditors with priority rights – because corporate debtors and major business partners involved in their third party claims or as general unsecured creditors (i) are usually more sophisticated and better financed, (ii) have more at stake, and (iii) have better and earlier access to relevant information – the record will typically be

[13] As one bankruptcy court recently noted in an opinion authorizing a structured dismissal that did *not* skip priorities, "[t]he best protection against collusion is upholding the absolute priority rule." *In re Olympic 1401 Elm Associates, LLC,* 2016 Bankr. LEXIS 3164, *9 (Bankr. N.D. Tex. Aug. 29, 2016).

[14] Notably, wise Third Circuit judges in this case disagreed on whether the bankruptcy judge's order could be justified as the "least bad alternative." *Compare* Pet. App. 21a (majority opinion, deeming the structured settlement the "least bad alternative") *with* Pet. App. 24a-25a (Scirica, J., dissenting) (declining to accept Sun's self-serving statements of its negotiating positions as proof that no better alternative could have been achieved).

framed in a way that favors corporate interests against those of small priority creditors. In a complex bankruptcy proceeding, laid-off employees or defrauded consumers are typically no match for sophisticated corporations that control the timing of filings, corporate information, and the creditors' committee.

In reality, therefore, while the Third Circuit would only permit a bankruptcy judge to override priorities in what it characterizes as a "rare" case, it could well become the norm for bankruptcy judges to be presented with one-sided records shaped by sophisticated bankruptcy practitioners to fit the Third Circuit's template. Moreover, insofar as the Third Circuit's mislabeling of an order that overrides the priority rights of unconsenting creditors as a "settlement" is accepted, bankruptcy judges would be operating against the backdrop of the general presumption in favor of settlements in bankruptcy law. And, perversely, whereas Congress inferred from small creditors' lack of bargaining power that they should be protected by priority rights, the Third Circuit's decision opens the door to a vicious circle whereby their lack of bargaining power leads courts to conclude that they could not have secured a better deal, such that the "least bad alternative" is a bad deal which the court then imposes, thereby further undermining their bargaining power. In combination, under the Third Circuit's approach, these factors are likely to make the "rare" remedy of priority-skipping commonplace. This should be no surprise: as petitioners note, bankruptcy law is littered with non-statutory "exceptions" that sophisticated practitioners have turned into standard practice. *See* Pet. Br. at 54-55.

Third, and perhaps most significant, the Third Circuit's rule would weaken the bargaining position of *all* priority creditors. The vast majority of bankruptcy issues are resolved by agreement, and so never receive meaningful review by bankruptcy judges or on appeal. Fully litigated cases are merely the tip of the iceberg. Small creditors with limited claims at stake and limited funds to pursue them are often under particular pressure to settle.

Like any other negotiation of legal claims, the negotiations that determine the outcomes for most of the small creditors that *amici* represent are framed by the legal rules that would apply if the case were contested.[15] Given a firm and certain priority rule, small creditors can strike fair deals. But under the Third Circuit's rule, with no guarantee that priority will ultimately be respected and the prospect of uncertain, difficult, costly litigation to contest a threatened priority-skipping structured dismissal order, small creditors will be compelled to accept much less favorable deals. Indeed, the effects of the Third Circuit's thumb on the scales against small creditors are already apparent in multiple bankruptcy negotiations. *See, e.g.,* Nick Brown, *Trucker's bankruptcy exit may roughen road for small creditors,* REUTERS (June 24, 2015),

[15] *See, e.g.,* Robert H. Mnookin & Lewis Kornhauser, *Bargaining in the Shadow of the Law: The Case of Divorce*, 88 YALE L.J. 950, 968-69 (1979) (describing how custody rules affect negotiated outcomes in divorce cases).

http://www.reuters.com/article/jevic-bankruptcy-idUSL1N0Z91BF20150624.

III. THE BANKRUPTCY CODE HAS SUFFICIENT FLEXIBILITY TO ACHIEVE MUTUALLY BENEFICIAL RESULTS FOR AFFECTED PARTIES WITHOUT THE THIRD CIRCUIT'S EXCEPTION

The Third Circuit majority argued that it would be "nihilistic and distrustful of bankruptcy judges" to deny them the discretion to order priority-skipping structured dismissals where they deem them to be the "least bad alternative." Pet. App. 23a. As explained in Section II.B above, giving bankruptcy judges the discretion to try to discern the "least bad alternative" falls far short of guaranteeing that the least bad alternative will, in fact, be secured. Moreover, there is a better way to achieve that goal – one that Congress has already provided.

The fallacy in the Third Circuit's reasoning is apparent in its discussion of alternatives. It concluded that the bankruptcy court's order was "the least bad alternative" because "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. Maybe so – although that ignores the potentially better alternative, at least for the employee petitioners, of a simple dismissal. A simple dismissal would have left unimpaired the employee petitioners' fraudulent transfer claims against Sun (which the bankruptcy court did not "get[] too far into the specifics of," Pet. App. 60a). That could have left them with some hope of recovery, unlike the bankruptcy court's order, which, against their consent and for no compensation, extinguished both their claims against the estate and their fraudulent transfer claims against Sun. *See* Pet. Br. 36-37.

But why couldn't the parties have reached a less bad alternative by settling with the employee petitioners? If, as the court concluded, the employee petitioners stood to get nothing unless they participated in a settlement, it would be rational for them to agree, pursuant to 11 U.S.C. § 1129(a)(8)(A), to a settlement that surrendered their priority rights in exchange for some guaranteed financial recovery. And if Sun and the general unsecured creditors understood that the bankruptcy court would not override the employee petitioners' priority rights for them for free, it would be rational for them to agree to a settlement on that basis.

The Third Circuit dismissed such notions as "counterfactual," contrary to bankruptcy court fact-findings, or inappropriate judicial interference to "reform settlements." Pet. Ap. 21a. But its reasoning is pure bootstrapping. The "facts" of what general unsecured creditors and third parties like Sun might agree to depend on their expectations of what the bankruptcy court can and will do. On the assumption that the bankruptcy court has the power and the inclination to override priorities on their behalf, of course they will not agree to pay priority creditors anything. But on the assumption that the priorities Congress enacted will be fully enforced – *i.e.,* that a settlement that results in some payment to the general unsecured creditors would be possible only if a deal were reached with the priority creditors – a different conclusion would be likely.

As Judge Scirica pointed out in dissent, a key reason why a settlement was not reached with the employee petitioners was that Sun insisted on cutting them out. *See* Pet. App. 24a-25a. That insistence by Sun may or may not have been a bluff. Sun was sufficiently eager to settle the estate's fraudulent transfer claims that it contributed $3.7 million to do so. So it is far from clear that, if pressed, allowing some of that money to go to the employee petitioners in accordance with their priority rights would have been a deal-breaker for Sun. The bankruptcy court could and should have called Sun's bluff by declining to enter an order stripping unconsenting priority creditors of their priority rights. Doing so would not entail improper judicial "reform [of] settlements," Pet. App. 21a; it would simply uphold the parties' rights so that the parties would have a sound and certain legal basis on which to negotiate.[16]

[16] The Third Circuit stated that "[t]here is no support in the record for the proposition that a viable alternative existed that would have better served the estate and the creditors as a whole." Pet. App. 22a. That conclusion appears to be based on Sun's self-serving claim that, unless the employee petitioners waived their WARN Act claims, Sun would not agree to any settlement in which they received anything. *See* Pet. App. 24a-25a (Scirica, J., dissenting) (explaining that the failure to reach a settlement with petitioner employees on which respondents relied to justify excluding the employees from any recovery "was, at least in part, a product of [respondents'] own making"). In other words, the record support the Third Circuit perceived to be lacking is evidence that Sun was bluffing. Corporations presenting a priority-skipping structured dismissal to a bankruptcy court for approval will generally be sophisticated enough to avoid

In reality, there is nothing "nihilistic" (Pet. App. 23a) about the Bankruptcy Code and its priority rules as written. Priority rights have the same inherent flexibility as other property rights: they can be bargained away in a contract for consideration if their owners consent. Priority creditors and unsecured creditors can reach efficient deals so long as the rules on which they base their negotiations – including priority rights – are clear and certain. Ironically, the greatest obstacle to true, efficient, consensual settlements is likely to be the Third Circuit's assertion that a bankruptcy judge has discretion to override the rights on which negotiations are founded in the name of "settlement."

CONCLUSION

For the foregoing reasons, the decision below should be reversed.

September 2, 2016

Respectfully submitted,

/s/ *Simon A. Steel*

---

supplying record evidence that they are bluffing, and it is not clear how the Third Circuit would expect small priority creditors to develop such evidence. In any event, bankruptcy judges are better suited to simply enforcing the Code's priorities than to engaging in poker-like games with the parties in order to speculate about what might be the "least bad alternative."

SIMON A. STEEL
Counsel of Record
JULIE A. WADDELL
C. JARRETT DIETERLE
HARKINS CUNNINGHAM LLP
1700 K Street, NW, Ste. 400
Washington, DC 20006
(202) 973-7600
ssteel@harkinscunningham.com

CATHERINE K. RUCKELSHAUS
NATIONAL EMPLOYMENT LAW PROJECT
75 Maiden Lane, Ste. 601
New York, NY 10038
(646) 693-8221
cruckelshaus@nelp.org

SALLY GREENBERG
NATIONAL CONSUMERS LEAGUE
1701 K Street, NW, Ste. 1200
Washington, DC 20006
(202) 835-3323
sallyg@nclnet.org

SEYMOUR W. JAMES, JR.
ADRIENE L. HOLDER
KAREN CACACE
LAURA RUSSELL
RICHARD BLUM
DIANE JOHNSTON
THE LEGAL AID SOCIETY
199 Water Street
New York, NY 10038
(212) 577-3648
rblum@legal-aid.org

KENNETH KIMERLING
ASIAN AMERICAN LEGAL DEFENSE AND EDUCATION FUND
99 Hudson St, 12th Fl.
New York, NY 10013
(212) 966 5932
kkimerling@aaldef.org