Washington Law Review

Volume 93 | Number 2

6-1-2018

The Secret Life of Priority: Corporate Reorganization after *Jevic*

Jonathan C. Lipson

THE SECRET LIFE OF PRIORITY: CORPORATE REORGANIZATION AFTER *JEVIC*

Jonathan C. Lipson*

Abstract: Academics have long debated whether the order of bankruptcy distributions should be "absolute" or "relative." Should courts have the flexibility to scramble priority to serve some greater good? The Supreme Court's recent decision in *Czyzewski v. Jevic Holding Corp.* holds that the answer is "no": priority is absolute absent the consent of affected creditors.

"Consent" is not self-defining, however, and is largely ignored in debates about priority. This is a problem because consent is hard to pinpoint in corporate reorganizations, a type of aggregate proceeding that can involve hundreds or thousands of creditors and shareholders. Although the *Jevic* majority does not define consent, its reasoning reflects a Court concerned about process values that proxy for it: stakeholder participation, outcome predictability, and procedural integrity. *Jevic* thus reveals a secret: "priority" is not only about the order in which a corporate debtor pays its creditors, but also about the process by which it does so.

I make three main points. First, I explain why "consent" is indeterminate in this context, inviting inspection of process quality. Second, I assess *Jevic*'s process-value framework. Implementing these values is not costless, so the Court's commitment to them suggests that efficiency—the mantra of many scholars—is not the only or necessarily the most important value in reorganization. Third, I argue that these values conflict with the power that senior secured creditors have gained in recent years to control corporate reorganizations. Many worry that this power produces needless expropriation and error. I conclude by sketching opportunities that *Jevic* creates for scholars and practitioners who share these concerns.

* Harold E. Kohn Professor of Law, Temple University-Beasley School of Law. This project has benefited from the help of many scholars and practitioners. Kenneth Ayotte, Craig Green, Bruce Grohsgal, Melissa Jacoby, and Ronald Mann were especially helpful. Similarly, counsel to the parties in *Jevic* provided valuable insights into what was at stake. Earlier versions of this paper were presented at the law schools of the University of Amsterdam, the University of Kentucky, Renmin University, and Tsinghua University, where participants provided valuable comments. I have also benefited from the excellent research and administrative support of Anjali Deshpande, Erica Maier, Katherine Osevala, Brian Thomas, and Steve Walsh. Dean Greg Mandel and the Harold E. Kohn Chair provided generous financial support. In the interest of full disclosure, I was co-counsel to certain amici in support of petitioners in *Jevic* before the Supreme Court. Errors and omissions are mine, alone.

INTRODUCTION

The Supreme Court's recent decision in *Czyzewski v. Jevic Holding Corp.*[1] is viewed as its most important opinion on corporate reorganization in at least a generation[2]—but often for the wrong reason.

Many view the opinion as being about "priority," the order in which a corporate debtor's assets are distributed when it completes the bankruptcy process.[3] Facially, this is correct: Justice Breyer, writing for a 6-2 majority, held that final distributions in a Chapter 11 bankruptcy must follow the "ordinary" and "basic" priority rules of the Bankruptcy Code absent "the affected creditors' consent."[4]

At a deeper level, however, *Jevic* is about process, and the values that should inform corporate reorganization practice. Here, the priority rules were in doubt only because the lower courts had approved a so-called

---

1. 580 U.S. __, 137 S. Ct. 973, 979 (2017).

2. *See* Ralph Brubaker, *Taking Bankruptcy's Distribution Rules Seriously: How the Supreme Court Saved Bankruptcy from Self-Destruction*, BANKR. L. LETTER, Apr. 2017, at 1 ("[T]he Supreme Court's recent decision in Czyzewski v. Jevic Holding Corp. has the potential to be one of the most consequential events for bankruptcy reorganization law and practice since the famous 1913 absolute-priority decision in Northern Pacific Railway v. Boyd." (footnote omitted)).

3. *See, e.g.*, Hollace T. Cohen, *Is the Absolute Priority Rule Alive and Well?* Jevic *Threatens the Rule and Other Core Bankruptcy Principles*, 26 NORTON J. BANKR. L. & PRAC. 45, 46 (2017) (writing prior to Supreme Court ruling that "[i]f Jevic is reversed, it will likely bar any deviation from the absolute priority rule in the context of a pre-plan settlement and may provide guidance with respect to deviation from other core bankruptcy principles in pre-plan settlements, whether the debtor is solvent or insolvent. If, however, Jevic is affirmed, it will allow a deviation from the absolute priority rule if the debtor is insolvent, without being faced with the question whether a deviation from that rule or any other core principle is permissible if the debtor is solvent"); Nicholas L. Georgakopoulos, *Through* Jevic*'s Mirror: Orders, Fees, and Settlements*, 72 BUS. LAW. 917, 935–36 (2017) (arguing that "the most pronounced consequence of *Jevic*" will be its effect on the priority of payments pursuant to so-called "first-day" orders in Chapter 11 cases); Bruce Grohsgal, *How Absolute Is the Absolute Priority Rule in Bankruptcy? The Case for Structured Dismissals*, 8 WM. & MARY BUS. L. REV. 439, 454 (2017) (criticizing *Jevic* and arguing that "a bankruptcy court has authority under the Code to approve a settlement and structured dismissal in a Chapter 11 case when it is in the best interest of creditors, even if distributions among unsecured creditors are not in accordance with the absolute priority rule"); Anna Haugen et al., *Re-"Structuring" Dismissal Flexibility: An Analysis of the Supreme Court's* Jevic *Decision*, AM. BANKR. INST. J., May 2017, at 12, 72 ("Practitioners should also expect additional scrutiny of any priority-violating [transactions] as lower courts grapple with the bounds of *Jevic*, especially in the face of creditor dissent.").

4. *Jevic*, 137 S. Ct. at 983; *see also id.* at 978 ("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 that apply under the primary mechanisms the Code establishes for final distributions of estate value in business bankruptcies."). Although they recognized that the *Jevic* Court "answer[ed] a novel and important question of bankruptcy law," Justices Alito and Thomas nevertheless dissented because "having persuaded us to grant certiorari on one question, petitioners chose to argue a different question on the merits." *Id.* at 987 (Thomas, J., dissenting). They would therefore have dismissed the petition on grounds that certiorari was improvidently granted. *Id.*

"structured dismissal," a procedural concoction under which senior and junior claimants sought to split the assets of the debtor, a trucking company, by skipping the "mid-priority" wage claims held by the petitioners, the debtor's terminated drivers.[5] As used in *Jevic*, this procedural maneuver threatened the foundations of the corporate reorganization system, not only its priority structure, but also its process framework.[6]

Structured dismissals have become an important vehicle for resolving Chapter 11 cases.[7] They substitute for the two main exit paths Congress created out of corporate bankruptcy, a "plan of reorganization" under Chapter 11—a cross between a consent decree and a contract[8]—or a trustee-supervised liquidation under Chapter 7 of the Bankruptcy Code.[9] Structured dismissals are attractive because they are cheaper than Chapter 11 plans, which require costly disclosure and creditor voting.[10] And, they are considered less risky than a Chapter 7 liquidation, where a trustee may impair recoveries by selling assets piece-meal and/or sue those who harmed the corporate debtor.[11] In many cases, including *Jevic*,

---

5. Official Comm. of Unsecured Creditors v. CIT Grp./Bus. Credit Inc. (*In re* Jevic Holding Corp.), 787 F.3d 173, 188 (3d Cir. 2015), *rev'd sub nom*. *Jevic*, 137 S. Ct. 973. *See generally* Order Granting Joint Motion of the Debtors, CIT, Sun Capital & the Official Committee of Unsecured Creditors Pursuant to 11 U.S.C. §§ 105(a), 349 & 1112(b) & Fed. R. Bankr. P. 9019 for Entry of an Order: (I) Approving Settlement Agreement & Releasing Claims; (II) Dismissing the Debtors' Cases Upon Implementation of Settlement; & (III) Granting Related Relief, *In re* Jevic Holding Corp., No. 08-11006 (BLS) (Bankr. D. Del. Dec. 4, 2012) [hereinafter Dismissal Order], *vacated*, Order at 1, *In re* Jevic Holding Corp., No. 13-104-SLR (D. Del. May 16, 2017).

As explained further below, a portion of the drivers' claims would be viewed as "mid-priority" because they were neither senior secured claims nor junior unsecured claims. Instead, they were entitled to a statutorily created fourth priority over general unsecured creditors. 11 U.S.C. § 507(a)(4) (2012).

6. *Jevic*, 137 S. Ct. at 986 (observing that the "consequences [of upholding the dismissal] are potentially serious").

7. *Id.* at 979 ("Although the Code does not expressly mention structured dismissals, they 'appear to be increasingly common.'" (quoting AM. BANKR. INST, COMMISSION TO STUDY THE REFORM OF CHAPTER 11: FINAL REPORT AND RECOMMENDATIONS 270 n.973 (2014) [hereinafter ABI REPORT])).

8. *See* Official Creditors Comm. of Stratford of Tex., Inc. v. Stratford of Tex., Inc. (*In re* Stratford of Tex., Inc.), 635 F.2d 365, 368 (5th Cir. 1981) (observing that reorganization plan "represents a kind of consent decree which has many attributes of a contract").

9. They are also an alternative to a "clean" or "unstructured" dismissal, where the case is simply dismissed without the special provisions found in structured dismissals including, as here, a deviation from absolute priority. *See* 11 U.S.C. §§ 349, 1112; discussion *infra* Part I (regarding dismissal standards and effects).

10. 11 U.S.C. §§ 1125–1126, 1129.

11. *Id.* § 726; *see, e.g.*, *In re* Hyatt, 509 B.R. 707, 722 (Bankr. D.N.M. 2014) (observing that Chapter 7 recoveries tend to be lower than those in Chapter 11).

the targets of those suits may be the very people who want the structured dismissal—those who controlled the debtor before liquidation.

Jevic taps into a long-running debate among bankruptcy scholars: should priority be "absolute," meaning that senior creditor *A* must be paid before junior creditor *B*, who must be paid before shareholder *C*, and so on?[12] Or, may we scramble the order, permitting "relative" priority in the service of some greater good?[13] The lower courts in *Jevic* took the latter view, believing that the greater good was closure—resolving a case that appeared hopeless because the debtor had no assets to fund a plan or trustee-supervised liquidation.[14]

The *Jevic* Court disagreed. In reversing, the majority established that priority is "absolute" absent consent. That is, consent trumps closure. But this also means that *Jevic* transforms the priority debate. Now, we

12. *See, e.g.*, Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 STAN. L. REV. 69, 123 (1991) (the "absolute priority rule has been the cornerstone of reorganization practice and theory"); Mark J. Roe & Frederick Tung, *Breaking Bankruptcy Priority: How Rent-Seeking Upends the Creditors' Bargain*, 99 VA. L. REV. 1235, 1236 (2013) (the absolute priority rule is "quite appropriately, bankruptcy's most important and famous rule"); *cf.* Barry E. Adler, *Game-Theoretic Bankruptcy Valuation*, 41 J. LEGAL STUD. 209, 214 (2012) ("Anticipation of breaches in absolute priority can raise a firm's ex ante cost of capital."). A notable earlier contribution is Walter J. Blum, *Full Priority and Full Compensation in Corporate Reorganizations: A Reappraisal*, 25 U. CHI. L. REV. 417, 437–39 (1958) (rejecting several "relative priority" proposals, including maintaining the old capital structure, having an "expansible valuation," and allowing the court to set a "maximum permissible capitalization").

13. *See, e.g.*, Douglas G. Baird, *Priority Matters: Absolute Priority, Relative Priority, and the Costs of Bankruptcy*, 165 U. PA. L. REV. 785, 792 (2017) (providing examples of relative priority); Anthony J. Casey, *The Creditors' Bargain and Option-Preservation Priority in Chapter 11*, 78 U. CHI. L. REV. 759, 765 n.2 (2011) ("The focus of Option-Preservation Priority is the relationship between classes of creditors and the decisions that affect the maximization of assets in Chapter 11."); Grohsgal, *supra* note 3, at 451 ("The absolute priority rule under the current Code is a special, limited rule. It is not a rule that operates substantively throughout the Code."); Richard Squire, *The Case for Symmetry in Creditors' Rights*, 118 YALE L.J. 806, 853–55 (2014) (arguing that "asymmetry" in priority produces opportunistic behavior). Earlier versions appear in James C. Bonbright & Milton M. Bergerman, *Two Rival Theories of Priority Rights of Security Holders in a Corporate Reorganization*, 28 COLUM. L. REV. 127, 130 (1928) (using "relative priority" as shorthand for "priority of income position"). Narrower definitions of relative priority might not view the distributions approved by the lower courts in *Jevic* as "relative priority." *See, e.g.*, Walter J. Blum, *The "New Directions" for Priority Rights in Bankruptcy Reorganizations*, 67 HARV. L. REV. 1367, 1368–69 (1954). But the underlying distributive mechanism and logic are the same: out-of-the-money juniors were to be paid over seniors' objections based on a view that this was a wealth-enhancing outcome.

14. Czyzewski v. Jevic Holding Corp., 580 U.S. __, 137 S. Ct. 973, 982 (2017) ("The [bankruptcy] court accordingly decided to grant the motion in light of the 'dire circumstances' facing the estate and its creditors. Specifically, the court predicted that without the settlement and dismissal, there was 'no realistic prospect' of a meaningful distribution for anyone other than the secured creditors. A confirmable Chapter 11 plan was unattainable. And there would be no funds to operate, investigate, or litigate were the case converted to a proceeding in Chapter 7." (internal citations omitted)).

know what the rule is—absolute priority in final distributions—but we must determine what comprises its exception, "consent." Ordinarily, "consent" for these purposes is shown by an affirmative creditor vote on a plan of reorganization. But, the structured dismissal—which, itself, survives *Jevic*—replaces the reorganization plan and its procedural protections, including creditor voting. The threat to those procedural protections was as great a problem as—perhaps greater than—the threat to the absolute priority rule (APR) sanctioned by the lower courts.

Discussions of priority rarely consider the role of consent in bankruptcy.[15] Instead, they focus on the economic merits of the rule-choices: does absolute or relative priority produce the greatest social welfare?[16] The omission is embarrassing, but not surprising. Absent creditors' vote on a plan, "consent" is difficult to pinpoint in corporate reorganization because it is a form of aggregate proceeding in which hundreds or thousands of creditors and shareholders assert different rights against a common debtor.[17] Is "consent" merely the failure to object to some important action in the case, such as a structured dismissal? Or does it require something more, such as affirmative assent? The majority in *Jevic* did not say, but the risk of false negatives is high because it is not clear whether a failure to object would signal consent—or simply a misunderstanding of what was at stake.

In theory, unsecured creditors may be represented by a committee and, as in *Jevic*, that committee may purport to consent on behalf of creditors. But because the same committee in *Jevic* technically represented both the settling unsecured creditors and the objecting drivers, the most we can say is that representative consent presents in bankruptcy the same ethical challenges we find in aggregate litigations,

---

15. *Cf.* Daniel J. Bussel & Kenneth N. Klee, *Recalibrating Consent in Bankruptcy*, 83 AM. BANKR. L.J. 663, 686–87 (2009) (discussing "consent" generally). Literature on "consent" in aggregate litigation is discussed *infra* Part II.

16. *See, e.g.*, Ralph Brubaker & Charles Jordan Tabb, *Bankruptcy Reorganizations and the Troubling Legacy of* Chrysler *and* GM, 2010 U. ILL. L. REV. 1375, 1396 (arguing that absolute priority promotes increased distribution values). Although not framed in terms of consent, Jay Westbrook was among the first to recognize the procedural powers that senior creditors can assert. *See* Jay Lawrence Westbrook, *The Control of Wealth in Bankruptcy*, 82 TEX. L. REV. 795, 797 (2004) ("[C]ontrol of the bankruptcy process, rather than formal rules of security and priority, is the key to understanding both secured-credit and bankruptcy law: Control is the function of bankruptcy; priority is the end for which it is employed.").

17. *See, e.g.*, Troy A. McKenzie, *Toward a Bankruptcy Model for Nonclass Aggregate Litigation*, 87 N.Y.U. L. REV. 960, 991 (2012) (discussing "[t]he hotly contested issue of claimant consent in the resolution of aggregate litigation").

generally: one agent cannot act effectively for adverse principals.[18] Worse, the statutory standards by which a court should assess structured dismissals are opaque, cobbled together from provisions that say nothing about them.[19] How can a court identify consent when no one knows what the rules are?

Jevic hints at some answers. Courts concerned about consent—in structured dismissals, and perhaps beyond—should assess the quality of the process that leads to important judicial action, such as case resolution. While *Jevic* does not define "consent," the majority opinion reveals a Court concerned about three process values that may proxy for it:

- *Participation*. Consent requires participation. The Chapter 11 plan is corporate reorganization's main participatory mechanism, in particular through disclosure and voting.[20] Because structured dismissals require neither, courts will have to decide what forms of "off-plan" participation permit an inference of consent.
- *Predictability*. Consent is more plausible—both to reach and to show—if the rules around which parties settle are more predictable. By choosing absolute, rather than relative, priority, *Jevic* narrows the range of possible outcomes and the standards by which they must be assessed.[21] Absolute priority increases predictability.
- *Procedural integrity*. Embedded in concerns about participation and predictability is anxiety about procedural integrity, in particular threats of collusion and opportunistic litigation.[22] These forms of misbehavior threaten the credibility of consent, and confidence in

18. The focus in aggregate litigation has often been on conflicts held by lawyers. *See, e.g.*, Howard M. Erichson & Benjamin C. Zipursky, *Consent Versus Closure*, 96 CORNELL L. REV. 265, 317 (2011) (criticizing quasi-class action settlements because they empower lawyers and "the empowerment of the lawyer is not purely in service of a better deal for clients. In this setting, the lawyer acquires more money than any of her clients"). Legal ethics in aggregate litigation are discussed *infra* Part II. In theory, separate committees may be appointed to represent priority creditors, such as Jevic's drivers, although the added cost makes that problematic.

19. As discussed *infra* Part I, structured dismissals are apparently vetted by courts under, among others, Bankruptcy Code §§ 349, 363, 1112 and Federal Rule of Bankruptcy Procedure 9019, none of which offer judges any guidance greater than "cause."

20. Czyzewski v. Jevic Holding Corp., 580 U.S. __, 137 S. Ct. 973, 986 (2017) ("[P]rohibiting an attempt to 'short circuit the requirements of Chapter 11 for confirmation of a reorganization plan by establishing the terms of the plan sub rosa in connection with a sale of assets.'" (quoting Pension Benefit Guar. Corp., Cont'l Airlines, Inc. v. Braniff Airways, Inc. (*In re* Braniff Airways, Inc.), 700 F.2d 935, 940 (5th Cir. 1983))).

21. *Id.* at 986 (discussing unpredictability introduced by lower courts' rationales).

22. *Id.* at 986–87 (warning of "risks of collusion, *i.e.*, senior secured creditors and general unsecured creditors teaming up to squeeze out priority unsecured creditors" (citing Bank of Am. Nat'l Tr. & Sav. Ass'n v. 203 N. LaSalle St. P'ship, 526 U.S. 434, 444 (1999))).

corporate reorganization, generally. *Jevic* is a reminder that bankruptcy judges must police the integrity of the reorganization process, even as they seek to maximize its payouts.

Like many process values, these are often lauded in principle and disputed in practice. Implementing them may be especially problematic in the "unruly"[23] world of corporate reorganization. They require time and money, which are usually scarce in this context. While earlier writers sometimes argued that bankruptcy should be treated as if it *were* a species of civil procedure,[24] they never explained what this meant, offered any theory of the process values that should underlie their proposal, or appreciated the procedural power that priority gives senior creditors which is, as explained below, the bane of corporate reorganization practice for many today.

The relationship between priority and process is severely undertheorized. Yet, that relationship threads the fabric of corporate reorganization. Many observers, for example, believe that senior creditors assert too much power over the reorganization process without considering the procedural leverage conferred by their seniority.[25] In the Chrysler[26] and General Motors[27] bankruptcies, for example, senior creditors used their priority status to obtain veto rights at the beginning of these cases that squelched participation, exposed other stakeholders to senior creditors' whims, and created the appearance of collusion.[28] A study of early maneuvers in *Jevic* shows a similar pattern: senior creditors gained control of the reorganization process at the outset, rendering the problematic structured dismissal there virtually inevitable.

23. *See* RadLAX Gateway Hotel, LLC v. Amalgamated Bank, 566 U.S. 639, 649 (2012) (noting the importance of clarity and predictability in light of the fact that the "Bankruptcy Code standardizes an expansive (and sometimes unruly) area of law").

24. Charles W. Mooney, Jr., *A Normative Theory of Bankruptcy Law: Bankruptcy as (Is) Civil Procedure*, 61 WASH. & LEE L. REV. 931, 934 (2004); *see also* Douglas G. Baird, *Bankruptcy's Uncontested Axioms*, 108 YALE L.J. 573, 576–77 (1998) (observing that in the 1990s there were "two distinct camps. In the first are traditional bankruptcy lawyers and scholars . . . . The [second] group's distinctive characteristic is its focus on procedure").

25. For ease of reference, I refer to senior secured creditors—whether acting as individual lenders or in groups—as "senior creditors." I refer to stakeholders whose claims are not secured by collateral in some way—including priority unsecured creditors, such as the drivers in *Jevic*—as "junior creditors/stakeholders." In rare cases where I discuss junior lienholders, I simply call them that.

26. *In re* Chrysler LLC, 576 F.3d 108, 118 (2d Cir.), *vacated as moot sub nom*. Ind. State Police Pension Tr. v. Chrysler LLC, 558 U.S. 1087 (2009) (mem.).

27. *In re* Gen. Motors Corp., 407 B.R. 463, 497 (Bankr. S.D.N.Y. 2009).

28. *See, e.g.*, Brubaker & Tabb, *supra* note 16, at 1378. *See generally* Mark J. Roe & David Skeel, *Assessing the Chrysler Bankruptcy*, 108 MICH. L. REV. 727 (2010); discussion *infra* section III.B.

Senior creditors are often the motivating force behind structured dismissals because they enable them to capture the benefits of bankruptcy's preemptive power without the costs of a plan or the scrutiny of a trustee-supervised liquidation.[29] Many worry that senior creditor control is the greatest threat facing the Chapter 11 system because it vests dominance in a single, largely unaccountable stakeholder.[30] Concentrated, unaccountable power leads to expropriation and error. It conflicts with *Jevic*'s process values because it debilitates participation by other stakeholders, reduces predictability, and undermines procedural integrity. It also upsets the balance Congress sought to strike between senior and junior claimants in the Bankruptcy Code that was intended to promote the process values articulated in *Jevic*.[31]

Although the subject matter is technical, this paper's claim is straightforward: *Jevic* reveals that the secret life of priority is not only about distributive rights, but also about process values of participation, predictability, and procedural integrity. Senior creditor power to control the reorganization process can threaten these values, so participants and observers after *Jevic* should rethink the (im)balance of power in Chapter 11.

The paper makes three main contributions. After summarizing *Jevic*, Part II explains problems with "consent" as a decisional standard for resolving corporate reorganizations absent a Chapter 11 plan. Part III assesses *Jevic*'s process-oriented framework as a proxy for consent. Part IV shows how senior creditors can use their priority rights to

---

29. Norman L. Pernick & G. David Dean, *Structured Chapter 11 Dismissals: A Viable and Growing Alternative After Asset Sales*, AM. BANKR. INST. J., June 2010, at 1, 58–59 (2010) (discussing use of structured dismissals where a corporate debtor has "no unsecured assets to administer or with insufficient unsecured assets to fund a confirmable chapter 11 plan").

30. *See, e.g.*, Charles J. Tabb, *The Bankruptcy Clause, the Fifth Amendment, and the Limited Rights of Secured Creditors in Bankruptcy*, 2015 U. ILL. L. REV. 765, 768 ("The reality then is that the entire reorganization is dependent on the good graces of the prebankruptcy controlling secured lender. That means that important stakeholders—bondholders, trade creditors, tort victims, employees, and shareholders, to name but a few—are excluded from any recovery but for the whims of the controlling secured creditor."); Westbrook, *supra* note 16, at 816–26 (developing model of "dominant" secured creditor).

31. The Bankruptcy Code was "designed to counteract the natural tendency of a debtor in distress to pacify large creditors, with whom the debtor would expect to do business, at the expense of small and scattered public investors." S. REP. No. 95-989, at 10 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5787, 5796; *see also* Juliet M. Moringiello, *When Does Some Federal Interest Require a Different Result?: An Essay on the Use and Misuse of* Butner v. United States, 2015 U. ILL. L. REV. 657, 658–59 ("[B]y giving secured creditors excessive control over business reorganizations, Chapter 11 no longer effectively balances its two primary goals, the effective reorganization of businesses and the maximization of asset values for all creditors.").

commandeer Chapter 11 cases, setting up a tension with *Jevic*'s process values. I close by briefly sketching opportunities for scholars and practitioners created by *Jevic*.

I. BACKGROUND

A. The Jevic *Bankruptcy*

Jevic Transportation Corporation (with affiliated debtors, "Jevic") was a New Jersey trucking company that began operations in 1981.[32] In 2006, Sun Capital Partners (Sun), a private equity firm, acquired Jevic with money borrowed from CIT Group (CIT) in a "leveraged buyout" (LBO).[33] In 2008, unable to service the LBO debt, Jevic went into Chapter 11 bankruptcy.[34] At the time of filing, it owed $53 million to senior secured creditors Sun and CIT, and over $20 million to tax and general unsecured creditors.[35] It had about 1,700 employees, most of whom it laid off shortly before bankruptcy.[36]

1. The Bankruptcy Litigations

There were two main litigations during Jevic's bankruptcy. First, petitioners, a group of former Jevic truck drivers, sued both Jevic and

32. *See* Emergency Motion for Interim & Final Orders (I) Authorizing Debtors-In-Possession to Enter into Senior Debtor-in-Possession Credit Agreement & Obtain Postpetition Financing Pursuant to Sections 363 & 364 of the Bankruptcy Code; (II) Granting Liens, Security Interests & Superpriority Claims; (III) Authorizing the Use of Cash Collateral; (IV) Affording Adequate Protection to Prepetition Lenders; & (V) Providing for the Payment of Secured Prepetition Indebtedness ¶ 8, *In re* Jevic Holding Corp., No. 08-11006 (BLS) (Bankr. D. Del. May 20, 2008) [hereinafter DIP Motion].

33. Czyzewski v. Jevic Holding Corp., 580 U.S. __, 137 S. Ct. 973, 980 (2017). In a leveraged buyout:

> [A]n acquirer may form a wholly owned subsidiary to buy the stock of the debtor (D) from D's pre-acquisition shareholders. The acquirer finances the acquisition by borrowing a significant portion of the purchase price, liability which it causes D to assume after closing, secured by D's assets. The (borrowed) purchase price is then remitted to D's pre-acquisition shareholders. This has the effect of giving D's selling shareholders the benefit of using D's assets to gain priority over D's pre-bankruptcy unsecured creditors, who will be junior in right to LBO lenders with liens encumbering D's assets.

Jonathan C. Lipson & Jennifer L. Vandermeuse, *Stern, Seriously: The Article I Judicial Power, Fraudulent Transfers, and Leveraged Buyouts*, 2013 WIS. L. REV. 1161, 1220.

34. *Jevic*, 137 S. Ct. at 980 ("Just two years after Sun's buyout, Jevic . . . filed for Chapter 11 bankruptcy.").

35. *Id.*

36. Czyzewski v. Jevic Transp., Inc. (*In re* Jevic Holding Corp.), 496 B.R. 151, 154–55 (Bankr. D. Del. 2013).

Sun claiming that they had violated state and federal Worker Adjustment and Retraining Notification (WARN) Acts, which require a company to give workers at least sixty days' notice before their termination (the "WARN suit").[37] The drivers won summary judgment against Jevic, but not against Sun, leaving a $12.4 million wage claim against the debtor, of which about $8.3 million was entitled to be paid before any distributions could be made to general unsecured creditors.[38] "[*T*]*his*," the Supreme Court majority observed emphatically, was "the point to remember."[39]

Second, the Bankruptcy Court authorized the committee representing Jevic's unsecured creditors ("creditors' committee" or "committee") to sue Sun and CIT for harm allegedly caused by the LBO (the "LBO suit").[40] Any recoveries from such a suit would belong to the bankruptcy estate.[41] The committee alleged that by virtue of the LBO, Sun and CIT had "hastened Jevic's bankruptcy by saddling it with debts that it couldn't service."[42] In 2011, the Bankruptcy Court held that the committee's claims survived a motion to dismiss.[43]

2. *The Structured Dismissal*

While the WARN suit proceeded, Sun, CIT, Jevic, and the creditors' committee negotiated a settlement of the LBO suit. The settlement provided the following:

- The Bankruptcy Court would dismiss the LBO suit with prejudice;

37. *Jevic*, 137 S. Ct. at 980 (citing 29 U.S.C. § 2102 (2012); N.J. STAT. ANN. § 34:21-2 (West 2011)).

38. *Id.* (citing *In re Jevic Holding Corp.*, 496 B.R. 151).

39. *Id.* Eventually Sun prevailed on the ground that Sun was not the workers' employer at the relevant times. *See generally In re* Jevic Holding Corp., 656 F. App'x 617 (3d Cir. 2016). Specifically, $8.3 million of the drivers' claims were entitled to fourth priority in distributions as unpaid wage claims. *See Jevic*, 137 S. Ct. at 980.

40. *Jevic*, 137 S. Ct. at 981.

41. *Id.* (citing 11 U.S.C. §§ 541(a)(1), (6) (2012); Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery, 330 F.3d 548, 552–53 (3d Cir. 2003) (en banc) (holding that a creditor's committee can bring a derivative action on behalf of the estate)).

42. *Id.* (quoting Official Comm. of Unsecured Creditors v. CIT Grp./Bus. Credit Inc. (*In re* Jevic Holding Corp.), 787 F.3d 173, 176 (3d Cir. 2015)).

43. *Id.* (citing Official Comm. of Unsecured Creditors v. CIT Grp./Bus. Credit Inc. (*In re* Jevic Holding Corp.), No. 08-11006 (BLS), 2011 WL 4345204 (Bankr. D. Del. Sept. 15, 2011)). Specifically, the committee had adequately pleaded claims of preferential transfer under Bankruptcy Code section 547 and of fraudulent transfer under section 548. *Id.*

- CIT would pay $2 million in legal fees of the committee's counsel; and
- Sun would assign its lien on Jevic's remaining $1.7 million to a trust to pay taxes and administrative expenses.[44]

The estate would distribute the remainder on a pro rata basis to the low-priority general unsecured creditors,[45] "*but . . . would not distribute anything to petitioners* (who, by virtue of their WARN judgment, held an $8.3 million mid-level-priority wage claim against the estate)."[46] Thereafter, the bankruptcy case would be dismissed, leaving all earlier court orders in effect.[47]

As a practical matter, these elements, known collectively as a "structured dismissal," had two key consequences. First, the distribution would skip the "mid-priority" claims of the drivers, even though there was no dispute about the drivers' entitlement to them. Second, the dismissal would free Sun and CIT from liability for the failed LBO they had orchestrated, which apparently led to the company's demise. Despite dismissing the bankruptcy, the truck drivers would be enjoined from suing Sun and CIT in state court for causes of action created by New Jersey's fraudulent transfer law.[48] In other words, the structured

---

44. *Id.*

45. Although Sun was principally Jevic's shareholder, it had acquired a lien on about $2 million of Jevic's assets by subrogation to CIT's rights when it (Sun) paid a portion of the CIT secured loan. *See* Joint Motion of the Debtors, CIT, Sun Capital & the Official Committee of Unsecured Creditors Pursuant to 11 U.S.C. §§ 105(a), 349 & 1112(b) & Fed. R. Bankr. P. 9019 for Entry of an Order: (I) Approving Settlement Agreement & Releasing Claims; (II) Dismissing the Debtors' Cases Upon Implementation of Settlement; & (III) Granting Related Relief Filed ¶ 7, *In re* Jevic Holding Corp., No. 08-11006 (BLS) (Bankr. D. Del. June 27, 2012) [hereinafter Dismissal Motion].

46. *Jevic*, 137 S. Ct. at 981. Apparently, Sun insisted on skipping the petitioners' priority wage claims because Sun did not want to fund litigation "against itself." *Id.* ("Sun's counsel acknowledging before the Bankruptcy Court that 'Sun probably does care where the money goes because you can take judicial notice that there's a pending WARN action against Sun by the WARN plaintiffs. And if the money goes to the WARN plaintiffs, then you're funding someone who is suing you who otherwise doesn't have funds and is doing it on a contingent fee basis.'" (quoting *In re Jevic Holding Corp.*, 787 F.3d at 177–78 n.4)).

47. *Id.*

48. As discussed below, section 349 of the Bankruptcy Code governs the effect of dismissals. It provides, in pertinent part, that "[u]nless the court, for cause, orders otherwise, a dismissal of a case . . . (3) revests the property of the estate in the entity in which such property was vested immediately before the commencement of the case under this title." 11 U.S.C. § 349(b) (2012). This means that dismissal should "undo the bankruptcy case, as far as practicable." H.R. REP. NO. 95-595, at 338 (1977). In *Jevic*, the Settlement Agreement released Sun and CIT from "third party actions or proceedings relating in any way to, or arising from any transaction with or in connection to, the Debtors or their estates of whatever kind or nature . . . including, without limitation, any and all claims asserted in or which could have been asserted in, or which related to the subject matter of

dismissal in *Jevic* would have both stripped the drivers of their priority claims in bankruptcy and forbidden them from pursuing any other remedies against those who allegedly harmed them outside of bankruptcy.

3. *The Problem as Framed—Priority Skipping*

The drivers objected, arguing that the structured dismissal "violated the [Bankruptcy] Code's priority scheme because it skipped petitioners—who, by virtue of their WARN judgment, had mid-level-priority claims against estate assets—and distributed estate money to low-priority general unsecured creditors."[49]

The Bankruptcy Court acknowledged this problem, but approved the structured dismissal anyway due to "the 'dire circumstances'" facing the estate and its creditors.[50] Jevic had borrowed more money from CIT during the case, secured on a "super-priority" basis by its assets, so that it apparently had no unencumbered assets.[51] It was, in the vernacular, "administratively insolvent," meaning that it could not pay first-priority expenses of administering the estate, much less any other "mid-priority" creditors, such as the drivers. The Bankruptcy Court "predicted that without the settlement and dismissal, there was 'no realistic prospect' of a meaningful distribution for anyone other than the secured creditors," CIT and Sun.[52] Thus, "[a] confirmable Chapter 11 plan was unattainable. And there would be no funds to operate, investigate, or litigate were the case converted to a [liquidation] proceeding in Chapter 7."[53]

The drivers appealed the order approving the structured dismissal to the United States District Court for the District of Delaware.[54] Although the district judge also recognized that the distributions under the structured settlement violated the Bankruptcy Code's priority scheme,

---

the Adversary Proceeding . . . ." Exhibit A to Joint Motion: Settlement Agreement ¶ 2(c)(i), *In re* Jevic Holding Corp., No. 08-11006 (BLS) (Bankr. D. Del. June 27, 2012). Among other things, this would have enjoined the drivers from suing under New Jersey's fraudulent transfer act. *See* N.J. STAT. ANN. § 25:2-20 (West 2015).

49. *Jevic*, 137 S. Ct. at 981.

50. *Id.* at 982 (quoting Petition for a Writ of Certiorari at 57a, *Jevic*, 137 S. Ct. 973 (No. 15-649)).

51. This financing, and the power that it gave CIT over the process, are discussed in detail *infra* section III.B.1.

52. *Jevic*, 137 S. Ct. at 982 (quoting Petition for a Writ of Certiorari, *supra* note 50, at 58a).

53. *Id.*

54. Czyzewski v. Jevic Holding Corp. (*In re* Jevic Holding Corp.), No. 08-11006(BLS), 2014 WL 268613 (D. Del. Jan. 24, 2014), *aff'd*, 787 F.3d 173 (3d Cir. 2015), *rev'd sub nom.* Czyzewski v. Jevic Holding Corp., 580 U.S. __, 137 S. Ct. 973 (2017).

she nevertheless approved the settlement because, she reasoned, the Bankruptcy Code's priority rules were "not a bar to the approval of the settlement as [the settlement] is not a reorganization plan."[55]

A divided Third Circuit Court of Appeals affirmed the District Court.[56] The majority held that structured dismissals need not always respect priority.[57] Congress, the appellate court explained, had only "codified the absolute priority rule . . . in the specific context of plan confirmation."[58] As a result, the court reasoned, bankruptcy courts could, "in rare instances like this one, approve structured dismissals that do not strictly adhere to the Bankruptcy Code's priority scheme."[59]

Judge Scirica concurred in part, but also dissented for three reasons. First, he questioned whether the proposed distributions were, in fact, wealth-maximizing, as the proponents had claimed.[60] Rather, he noted, the priority-skipping distribution "deviates from the Code's priority scheme so as to maximize the recovery that certain creditors receive," at the expense of higher priority creditors (the drivers).[61] Second, anticipating Justice Breyer's concerns about process quality, he worried that the structured dismissal here was a substitute for a plan without the procedural protections of a plan.[62] Third, he noted, the secured creditors here should have had no power to make a "gift" to junior unsecured creditors, as they had sought, because the settlement proceeds were property of the estate—not property of CIT or Sun to give as they wished.[63]

---

55. *Id.* at *3. This was an especially odd finding, as the exit path most likely to permit deviations of this sort would have been a plan, which permits greater flexibility in altering priorities than a Chapter 7 liquidation.

56. Official Comm. of Unsecured Creditors v. CIT Grp./Bus. Credit Inc. (*In re* Jevic Holding Corp.), 787 F.3d 173, 175 (3d Cir. 2015), *rev'd sub nom.* Czyzewski v. Jevic Holding Corp., 580 U.S. __, 137 S. Ct. 973 (2017); *id.* at 186 (Scirica, J., concurring in part and dissenting in part).

57. *Id.* at 183–84 (majority opinion).

58. *Id.* at 183.

59. *Id.* at 180.

60. *Id.* at 187 (Scirica, J., concurring in part and dissenting in part).

61. *Id.*

62. *Id.* at 188 ("Although the combination of the settlement and structured dismissal here does not, strictly speaking, constitute a sub rosa plan—the hallmark of such a plan is that it dictates the terms of a reorganization plan, and the settlement here does not do so—the broader concerns underlying the sub rosa doctrine are at play.").

63. *Id.* ("Critical to this analysis is the fact that the money paid by the secured creditors in the settlement was property of the estate. A cause of action held by the debtor is property of the estate.").

4. *Jevic in the Supreme Court—Priority in Final Distributions*

Before the Supreme Court, the "basic question" was, "[c]an a bankruptcy court approve a structured dismissal that provides for distributions that do not follow ordinary priority rules without the affected creditors' consent?"[64] The Court's "simple answer to this complicated question" was "'no.'"[65]

Justice Breyer's majority opinion opened with the sweeping claim that "[t]he [Bankruptcy] Code's priority system constitutes a basic underpinning of business bankruptcy law."[66] This priority system applies in either of the two major exit paths envisioned by Congress: a reorganization plan under Chapter 11 or a liquidation supervised by a trustee under Chapter 7.[67] The structured dismissal devised by the settling parties in *Jevic* was simply an end-run around this system; the Court would not tolerate it.

The Bankruptcy Code recognizes three sets of "ordinary" priority rules: (1) those provided by state law, with respect to secured claims, which confer priority rights (liens) in a debtor's property, such as those held by CIT on Jevic's assets;[68] (2) statutory priority rights under Bankruptcy Code section 507, such as the one giving the drivers' wage claims fourth ("mid") priority as unsecured claims;[69] and (3) the common law "absolute priority rule," which applies to plans of reorganization and (now we know) structured dismissals, and more generally contemplates that creditors have priority over owners (e.g., shareholders).[70]

The Court observed that these priority rules—in particular, the APR—have "long been considered fundamental to the Bankruptcy Code's operation" because, among other reasons, they "enforce a distribution of the debtor's assets in an orderly manner . . . in accordance

---

64. Czyzewski v. Jevic Holding Corp., 580 U.S. __, 137 S. Ct. 973, 983 (2017).

65. *Id.*

66. *Id.*

67. *Id.* ("Distributions of estate assets at the termination of a business bankruptcy normally take place through a Chapter 7 liquidation or a Chapter 11 plan, and both are governed by priority. In Chapter 7 liquidations, priority is an absolute command—lower priority creditors cannot receive anything until higher priority creditors have been paid in full." (citing 11 U.S.C. §§ 725–726 (2012))).

68. For example, under Article 9 of the Uniform Commercial Code, which governs security interests in personal property and has been enacted in all fifty states.

69. 11 U.S.C. § 507(a).

70. *Id.* § 1129(b). The Bankruptcy Code also recognizes contractual subordination, which is the creation of priority by agreement. *Id.* § 510(a).

with established principles rather than on the basis of the inside influence or economic leverage of a particular creditor."[71] Thus, the Court noted, the APR is "quite appropriately, bankruptcy's most important and famous rule"[72] and is "the cornerstone of reorganization practice and theory."[73]

This was important, for it showed that the majority understood that plans and liquidations were the two main routes out of bankruptcy, and that a kind of "absolute" priority structure applied in either case. If Congress had intended to permit non-consensual deviations—a third way out, such as the *Jevic* structured dismissal—it would have said so. "[W]e 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 Code prohibits in Chapter 7 liquidations and Chapter 11 plans."[74] Because Congress does not "hide elephants in mouseholes,"[75] the majority concluded that the priority rules that applied in a Chapter 11 plan or a Chapter 7 liquidation should also apply in a structured dismissal.[76]

B. Problems with Structured Dismissals—"Cause" and Effects

Although *Jevic*'s holding focused on the priority rules that apply in final distributions of estate property, it was driven by the particular mechanism used to resolve the case, a "structured dismissal," a procedural concoction neither defined nor contemplated by the Bankruptcy Code.[77] The *Jevic* majority was careful to say that it took no position on the propriety of structured dismissals.[78] Parsimony here is not surprising because no one in *Jevic* challenged the legality of

---

71. *Jevic*, 137 S. Ct. at 984 (quoting H.R. REP. NO. 103-835, at 33 (1994)).

72. *Id.* (quoting Roe & Tung, *supra* note 12, at 1243, 1236).

73. *Id.* (quoting Markell, *supra* note 12, at 123).

74. *Id.*

75. *Id.* (quoting Whitman v. Am. Trucking Ass'ns, Inc., 531 U.S. 457, 468 (2001)).

76. *Id.* at 984–86.

77. Justice Breyer's majority opinion relied on a definition supplied by an American Bankruptcy Institute study, characterizing a structured dismissal as a "'hybrid dismissal and [plan] confirmation order . . . that . . . typically dismisses the case while, among other things, approving certain distributions to creditors, granting certain third-party releases, enjoining certain conduct by creditors, and not necessarily vacating orders or unwinding transactions undertaken during the case.'" *Id.* at 979 (quoting ABI REPORT, *supra* note 7, at 270).

78. *Id.* at 985 (the Court "express[ed] no view about the legality of structured dismissals in general").

structured dismissals, as such. But it is unfortunate, because structured dismissals are governed by a "for cause" standard, which provides little guidance to lower courts.[79] The absence of clear standards has, in turn, created ambiguities that powerful stakeholders such as senior creditors (here, CIT and Sun) may exploit to control the reorganization process, as nearly happened in *Jevic*.

1. Approval Standards—"Cause"

Structured dismissals are governed by several provisions of the Bankruptcy Code, which give bankruptcy judges a wide berth in deciding whether to approve them. First, Bankruptcy Code section 1112 provides that a court may dismiss a Chapter 11 case for "cause,"[80] and lists sixteen non-exclusive factors that count as cause to grant a dismissal motion.[81] These include "substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation."[82] This is important because Chapter 11 debtors, including Jevic, often enter bankruptcy with assets fully encumbered (or nearly so). This leaves them at or near the point of administrative insolvency—a financial condition where the debtor cannot even pay its operating expenses during the case.[83] If a corporate debtor is administratively insolvent, there may well be little "likelihood of rehabilitation," and thus "cause" to dismiss the case.[84]

Second, structured dismissals are governed in part by Bankruptcy Code section 363, which deals with non-ordinary-course uses of property.[85] When a debtor, such as Jevic, commences a Chapter 11 case,

---

79. *See In re* Biolitec, Inc., 528 B.R. 261, 269 (Bankr. D. N.J. 2014) ("'Not much law, statutory or otherwise, exists regarding structured dismissals . . . .'" (quoting *In re* Buffet Partners, No. 14-30699-HDH-11, 2014 WL 3735804, at *2 (Bankr. N.D. Tex. July 28, 2014))).

80. 11 U.S.C. § 1112(b)(1) (2012) ("[T]he court shall convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, for cause . . . .").

81. *Id.* § 1112(b)(4)(A). One could quibble with the number sixteen. Some enumerated factors actually contain sub-factors. *See, e.g.*, *id.* § 1112(b)(4)(J) (listing "failure to file a disclosure statement, or to file or confirm a plan, within the time fixed by this title or by order of the court").

82. *Id.* § 1112(b)(4)(A).

83. Administrative insolvency means that a debtor is unable to pay the ongoing expenses of operating in bankruptcy, which courts often find to be grounds to convert or dismiss a case. *See, e.g.*, *In re* Acme Cake Co., 495 B.R. 212, 217 (Bankr. E.D.N.Y. 2010).

84. But that may prove too much because debtors are so frequently near administrative insolvency. *See* ABI REPORT, *supra* note 7, at 173 (noting that "'administratively insolvent' cases have become more common").

85. To determine whether a transaction falls outside the ordinary course of business, courts utilize both a "horizontal" and "vertical" test. The horizontal test evaluates whether, from an industry-wide

an "estate" is created, comprised of all of the company's property.[86] Corporate managers become fiduciaries of the estate, for the benefit of general unsecured creditors,[87] as "debtor in possession" (DIP). While the DIP may run the business as usual during bankruptcy, managers may not use estate (company) property outside the ordinary course absent court approval.[88]

Because a structured dismissal seeks to make a final distribution of estate property, a structured dismissal would do just that. Courts tend to defer to management's good faith business judgment regarding non-ordinary uses of property under section 363.[89] As with "cause" to dismiss, it will not be difficult to show a business justification where a debtor is administratively insolvent. In essence, proponents would argue that the structured dismissal for purposes of section 363 is a fancy "sale" of all of the debtor's assets. If, as happened in *Jevic* below, the DIP and senior creditors have agreed to this, courts understandably find themselves tempted to go along, even if "mid-priority" creditors object.

Third, because a structured dismissal also appears to involve a "settlement," it is governed by Federal Rule of Bankruptcy Procedure 9019,[90] a rule with even less content than the sales provisions of section 363. This rule—not technically a part of the Bankruptcy Code—provides simply that "[o]n motion by the [DIP] and after notice and a hearing, the court may approve a compromise or settlement."[91]

Courts recognize that approval of a proposed settlement is not a "fait accompli."[92] They must assess it under *some* standard. In 1968, the Supreme Court held in the pre-Code *Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson*[93] case

---

perspective, the transaction at issue is one that is commonly taken by companies in the industry. The vertical test evaluates whether, from a hypothetical creditor's perspective, "the transaction subjects a creditor to economic risk of a nature different than those he accepted when he decided to extend credit." *In re* Nellson Nutraceutical Inc., 369 B.R. 787, 797 (Bankr. D. Del. 2007). Failure to satisfy either the horizontal or vertical test may render a transaction outside the ordinary course. *See In re* Roth Am., Inc., 975 F.2d 949, 953 (3d Cir. 1992).

86. 11 U.S.C. § 541(a).

87. *Id.* §§ 1107–1108.

88. *Id.* § 363(b)(1).

89. *In re* Kennedy, 552 B.R. 183, 194 (Bankr. E.D. Tenn. 2016); *In re* Shary, 152 B.R. 724, 725 (Bankr. N.D. Ohio 1993); *see also* Comm. of Equity Sec. Holders v. Lionel Corp. (*In re* Lionel Corp.), 722 F.2d 1063, 1071 (2d Cir. 1983).

90. FED. R. BANKR. P. 9019.

91. *Id.*

92. *In re* ICL Holding Co., 802 F.3d 547, 551–52 (3d Cir. 2015).

93. 390 U.S. 414 (1968).

that settlements must be "fair and equitable."[94] This phrase has become code (and Code) for "absolute priority." One of the main doctrinal points of contention in *Jevic* was whether this notion of priority applied to the settlement in *Jevic* or only, as the lower courts held, to plans of reorganization, whose rules do indeed codify the "fair and equitable" standard as one of absolute priority.[95] While the *Jevic* Court decisively answered this particular doctrinal question—the absolute priority standard governs final distributions in Chapter 11, even if made via a settlement—the majority opinion did not provide clarity about how bankruptcy courts should assess settlements generally.

This, too, is a problem because, in addition to (or perhaps in lieu of) *TMT Trailer Ferry*'s absolute priority rule, courts have held that they must weigh the "value of the claim that is being compromised against the value to the estate of the acceptance of the compromise proposal."[96] This, in turn, asks a court to apply a multifactor test which, at least in the Third Circuit (the source of *Jevic*), is set out in *In re Martin*[97]: "(1) the probability of success in litigation; (2) the likely difficulties in collection; (3) the complexity of the litigation involved, and the expense, inconvenience and delay necessarily attending it; and (4) the paramount interest of the creditors."[98]

There is, unfortunately, no necessary connection between any of these four "*Martin*" factors and the absolute priority rule upheld in *Jevic*. These factors assume the existence of a litigated dispute. While that was the case in *Jevic*, it need not be, because ordinary adversarial litigation need not occur in a Chapter 11 bankruptcy. Indeed, as explained below, given senior creditors' power to usurp the Chapter 11 process, such lawsuits are likely to dwindle. Moreover, it provides no guidance on how a court is supposed to decide what constitutes the "paramount interests of creditors." If we care only (or mostly) about senior creditors, then whatever they want will be "paramount." If, instead, we care about

94. *Id.* at 424. Although *TMT Trailer Ferry* involved a compromise and settlement, it occurred before promulgation of Rule 9019. Courts under current law nevertheless look to it for guidance when asked to approve settlements in bankruptcy. *See* Motorola, Inc. v. Official Comm. of Unsecured Creditors (*In re* Iridium Operating LLC), 478 F.3d 452, 462–63 (2d Cir. 2007).

95. Czyzewski v. Jevic Holding Corp., 580 U.S. __, 137 S. Ct. 973, 983–84 (2017); *see also* 11 U.S.C. § 1129(b) (2012).

96. *In re* World Health Alts., Inc., 344 B.R. 291, 296 (Bankr. D. Del. 2006) (internal quotation marks omitted).

97. 91 F.3d 389, 393 (3d Cir. 1996).

98. *Id.*; *see also In re* ICL Holding Co., 802 F.3d 547, 551–52 (3d Cir. 2015) (applying *Martin* factors).

other mid- or low-priority creditors, we might take a different view.[99] Although Congress designed the Bankruptcy Code to protect the latter, Chapter 11 is increasingly dominated by the former, aided by innovations such as structured dismissals.

2. *Problems with Structured Dismissals—Effect*

The standards by which courts should assess structured dismissals are unclear, leaving judges exposed to pressure from senior creditors who wish to use them to resolve Chapter 11 cases to their liking. While this contributes to uncertainty, the harder doctrinal question, only partially answered by *Jevic*, involves their effect if approved.

As noted above, Bankruptcy Code section 349 provides, in pertinent part, that "[u]nless the court, for cause, orders otherwise, a dismissal of a case . . . (3) revests the property of the estate in the entity in which such property was vested immediately before the commencement of the case under this title."[100] Thus, as with the decision whether to dismiss, altering the prebankruptcy status quo through dismissal depends on a showing of "cause."

The statute provides no examples of what might constitute "cause," so courts have looked to legislative history. Congress observed that dismissal should "undo the bankruptcy case, as far as practicable."[101] This means that dismissal should restore the status quo ante, so that creditors could pursue their remedies in other fora, such as state court. In *Jevic*, Justice Breyer recognized that the "cause" exception Congress had in mind involved reliance interests developed during the case.[102] For example, if a creditor received consideration for releasing liens during the case, the creditor should retain the consideration if it cannot get its lien back.[103] Yet, many of the important features of a structured

99. *Compare In re* Buffet Partners, No. 14-30699-HDH-11, 2014 WL 3735804, at *2 (Bankr. N.D. Tex. July 28, 2014) ("[T]he best interests of creditors test focuses on the interest of the entire creditor body; it does not focus on individual creditor interests."), *with* Rollex Corp. v. Associated Materials, Inc. (*In re* Superior Siding & Window, Inc.), 14 F.3d 240, 243 (4th Cir. 1994) (noting that "the court must consider the interests of all of the creditors" and that the best interests of creditors are "not served by merely tallying the votes of the unsecured creditors and yielding to the majority interest").

100. 11 U.S.C. § 349(b).

101. H.R. REP. NO. 95-595, at 338 (1977).

102. Czyzewski v. Jevic Holding Corp., 580 U.S. __, 137 S. Ct. 973, 984 (2017) ("[T]his provision appears designed to give courts the flexibility to 'make the appropriate orders to protect rights acquired in reliance on the bankruptcy case.'" (quoting H.R. REP. NO. 95-595, at 338)).

103. *See, e.g.*, *In re* Sadler, 935 F.2d 918, 921 (7th Cir. 1991) (reversing lower court's approval of a dismissal order that stripped a secured creditor of its collateral).

dismissal—in *Jevic*, the final distributions and release—would not reflect reliance on actions taken *during* the case. Instead, those actions altered the prebankruptcy status quo in reliance on actions to *end* the case.

After *Jevic*, those who wish to use structured dismissals may face at least three questions about their effect. First, the majority opinion focused on one type of priority skipping—"vertical"—that meant that seniors and juniors could not ignore the rights of those in the middle.[104] But, there is also "horizontal" priority, which considers whether, or to what extent, stakeholders with the same priority receive the same treatment.[105] That is, could the structured dismissal in *Jevic* have paid some but not all of the mid-priority claims of the drivers in order to "purchase" their consent? Traditional resolution mechanisms—Chapter 11 plans and Chapter 7 liquidations—generally resist this, resting on the maxim "equity is equality."[106] The rules governing structured dismissals, however, say nothing about it, and neither does the majority in *Jevic*.

Second, *Jevic* does not address the related practice of "gifting," where senior creditors use a portion of their recovery to induce junior creditors to vote for a plan.[107] Economically, gifting can have the same effect as the forbidden distributions in *Jevic*, because distributions may "skip" priority, but it is rationalized on a different theory—that the senior

---

104. *See generally* Bruce A. Markell, *A New Perspective on Unfair Discrimination in Chapter 11*, 72 AM. BANKR. L.J. 227 (1998).

105. *See id.* at 231.

106. *See, e.g.*, Adam J. Levitin, *Toward a Federal Common Law of Bankruptcy: Judicial Lawmaking in a Statutory Regime*, 80 AM. BANKR. L.J. 1, 8 (2006) ("[T]he priority scheme of the Code and the requirement of equal treatment of creditors within the same class is an implementation of the equity maxim that 'equity is equality'—like creditors are to be treated alike." (footnotes omitted)). In Chapter 11, Bankruptcy Code section 1129(b) implements this by providing that a reorganization plan may not "discriminate unfairly" amongst creditors in the same class. 11 U.S.C. § 1129(b)(1) (2012). Discrimination may nevertheless occur, and often arises in the context of so-called "death-trap" provisions of Chapter 11 plans. These will reward a class with better treatment for voting for the plan, even if doing so provides better treatment than received by a similarly situated class. As the influential Bankruptcy Court for the Southern District of New York recently explained, "death-trap . . . provisions have long been customary in Chapter 11 plans." *In re* MPM Silicones, LLC, No. 14-22503-rdd, 2014 WL 4637175, at *3 (Bankr. S.D.N.Y. Sept. 17, 2014) (citing *In re* Adelphia Commc'ns Corp., 368 B.R. 140, 275 (Bankr. S.D.N.Y. Jan. 3, 2007); *In re* Drexel Burnham Lambert Grp., Inc., 138 B.R. 714, 717 (Bankr. S.D.N.Y. Mar. 4, 1992)).

107. *Compare In re* Armstrong World Indus., Inc., 432 F.3d 507, 514–16 (3d Cir. 2005), *with* Hargreaves v. Nuverra Envtl. Sols., Inc. (*In re* Nuverra Envtl. Sols., Inc.), No. 17-10949-KJC, 2017 WL 3326453, at *3 (Bankr. D. Del. Aug. 3, 2017) (distinguishing *Armstrong* and affirming confirmation of plan that made a "gift from senior lenders to certain, but not all, classes of general unsecured creditors"), *In re* World Health Alts., Inc., 344 B.R. 291, 297 (Bankr. D. Del. 2006) (approving senior creditor "gift"), *and In re* ICL Holding Co., 802 F.3d 547, 549 (3d Cir. 2015) (same).

creditor is using "its" property and not the estate's.[108] The bankruptcy process should be indifferent to the ways in which a creditor uses its property and so, on this view, gifting is outside the purview of bankruptcy judges. Although an important and controversial practice—courts appear to be split on whether it is permissible[109]—*Jevic* offers no direct guidance on whether it may continue.

Third, the distributive rights vindicated in *Jevic* are hardly the only ones that a structured dismissal might compromise. In *Jevic*, for example, the senior creditors sought the structured dismissal in part to escape potential liability for the failed LBO, which might have constituted a fraudulent transfer.[110] To avoid this liability, the structured dismissal approved would have prevented anyone—including the objecting drivers—from suing the senior creditors on these theories outside of bankruptcy, after dismissal.[111] In principle, one party cannot "agree" to eliminate the rights of another, but that is what the structured dismissal sought to do.[112]

II. CONSENT—THE SOLUTION?

Jevic suggests that the foregoing problems with structured dismissals could be cured with "the affected creditors' consent."[113] While this has intuitive appeal—bankruptcy is designed to promote negotiated

---

108. *In re ICL Holding Co.*, 802 F.3d at 549.

109. *Compare In re Armstrong World Indus.*, 432 F.3d at 514–16 (forbidding inter-class transfers to junior stakeholders), *with In re World Health Alts.*, 344 B.R. at 297 (approving secured creditor "gift" to general unsecured creditors).

110. As explained below, the LBO suit was predicated on the view that transfers in the LBO (including liens granted to secure CIT's loan financing the transaction) were constructively fraudulent under, e.g., 11 U.S.C. § 548.

111. Specifically, the Settlement Agreement releases CIT and Sun from:

> [A]ny and all claims or counterclaims, causes of action, remedies, damages, liabilities, debts, suits, demands, actions, costs, expenses, fees, controversies, set-offs, third party actions or proceedings relating in any way to, or arising from any transaction with or in connection to, the Debtors or their estates of whatever kind or nature . . . including, without limitation, any and all claims asserted in or which could have been asserted in, or which related to the subject matter of the Adversary Proceeding, or which are based on any avoidance or other powers afforded the Estate Releasing Parties under the Bankruptcy Code . . . .

Exhibit A to Joint Motion: Settlement Agreement, *supra* note 48, ¶ 2(c)(i).

112. Local No. 93, Int'l Ass'n of Firefighters v. City of Cleveland, 478 U.S. 501, 529 (1986) ("[P]arties who choose to resolve litigation through settlement may not dispose of the claims of a third party, and *a fortiori* may not impose duties or obligations on a third party, without that party's agreement.").

113. Czyzewski v. Jevic Holding Corp., 580 U.S. __, 137 S. Ct. 973, 983 (2017).

solutions[114]—it simply pushes the question back one step: what is "consent" in this context? Under a Chapter 11 plan, consent is shown by a creditor vote.[115] But, because the Bankruptcy Code creates no mechanism to vote on structured dismissals—or most important matters other than reorganization plans—courts after *Jevic* will be asked to think more seriously about what constitutes consent in Chapter 11 cases, which will be challenging for reasons discussed in this Part.

A. Problems with Consent

Even outside of bankruptcy, Prosser noted, the question of "consent" "is one of the most complex and difficult in the entire area of the law."[116] The scale and multilateral character of most Chapter 11 cases only exacerbate this.

Problems of consent here usually take one of three forms: (1) false positives; (2) false negatives; and (3) strategic dissent.

- A "false positive" means that there is some affirmative indication that a party has agreed to something in a case, but the assent is compromised. It may be the product of mistake, duress, bad faith, or worse.
- A "false negative" means that there is no affirmative indication of assent or dissent (objection), but a judge mistakenly interprets silence as assent.
- A "strategic dissent" is an objection made not on the merits, but instead for some other instrumental end.[117]

While all three are problematic, the second may be worst because it is so difficult to know what to infer from silence. If, for example, the drivers in *Jevic* had not retained separate counsel and objected

---

114. *See* Jonathan C. Lipson, *Bargaining Bankrupt: A Relational Theory of Contract in Bankruptcy*, 6 HARV. BUS. L. REV. 239, 256 (2016).

115. 11 U.S.C. § 1126 (setting forth plan voting rules). Although beyond the scope of this paper, "consent" is also an issue in municipal bankruptcies under Chapter 9 of the Bankruptcy Code. *See* Melissa B. Jacoby, *Federalism Form and Function in the Detroit Bankruptcy*, 33 YALE J. ON REG. 55, 105 (2016) ("The Detroit court used . . . [the consent standard under Chapter 9] as an oversight tool. That approach puts a premium on a municipality exercising free choice.").

116. W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 18, at 112 (5th ed. 1984).

117. *See, e.g.*, Jonathan C. Lipson, *Understanding Failure: Examiners and the Bankruptcy Reorganization of Large Public Companies*, 84 AM. BANKR. L.J. 1, 3 (2010) ("[J]udges are often reluctant to appoint an examiner if there is no apparent benefit to the estate or if a party requests one for transparently strategic reasons.").

vigorously to the structured dismissal, should the bankruptcy court have approved the settlement anyway, on the theory that silence *was* consent?

1. We Know It When We See It

Professors Klee and Bussel have spent the most time thinking about what consent means in bankruptcy, arguing that it is (or should be) a "contextualized inquiry that draws on both experience and judgment."[118] They identify ten factors ("no doubt there are many others") that they "believe are often relevant to fixing appropriate consent requirements and standards in bankruptcy."[119] These factors balance "legitimacy and autonomy values . . . against the efficiency of dictating a given result by mandatory rule."[120]

Klee and Bussel's instincts seem consistent with the reasoning of *Jevic*—process-quality matters[121]—but their approach may leave too many degrees of freedom. First, it is not clear whether they are describing the matters as to which consent may be an appropriate resolution standard or, instead, how to decide if there is, in fact, consent.[122] It may be one, the other, or both, but they do not say.[123]

Second, if we take the question to involve the latter—have parties consented?—it is not clear which factors matter, or how courts should weight them in a dispute. Consider their first two: the "sophistication, knowledge and bargaining power of the putative consenting parties;" and the "number, and degree of geographical or other dispersion, of the putative consenting parties."[124] It is not clear how a bankruptcy judge in a case with hundreds or thousands of creditors can know these things with confidence. Judges could require representatives in the case—in

118. Bussel & Klee, *supra* note 15, at 718.

119. *Id.* at 717; *see also id.* at 719 ("[L]egitimacy and autonomy values must be weighed against the efficiency of dictating a given result by mandatory rule.").

120. *Id.*

121. *Id.* ("[W]e . . . should be wary of sacrificing too quickly the legitimacy consent confers on the altar of efficient administration or other bankruptcy values.").

122. *Id.* at 718 (writing courts should "consider . . . the extent to which consent is a necessary or sufficient predicate to the transformation of legal rights").

123. Take a simple example. Creditors with statutory priority, such as the drivers in *Jevic*, may consent to waive their priority rights, so this would be a matter as to which consent is a permissible resolution mechanism. But, in the context of confirming a plan of reorganization, a court must find that the proposed plan is "feasible." 11 U.S.C. § 1129(a)(11) (2012). In theory, this is an independent judicial assessment; no amount of "consent" should supplant the court's independent judgment. Klee and Bussel do not tell us whether consent should be effective in both cases, or only in the first.

124. Bussel & Klee, *supra* note 15, at 718.

particular, counsel to the unsecured creditors' committee—to obtain something like proxies from each creditor as to each matter. But unsophisticated parties may mistakenly agree (a false positive). More likely, parties may simply say nothing (possibly a false negative). In any case, how much money would we want a debtor's estate to spend on this? Voting is expensive. While its costs are clear, its benefits are often opaque.

Klee and Bussel would seem to give to bankruptcy judges a great deal of discretion in deciding when consent is appropriate, and how to decide whether it exists. These judges would, to paraphrase Justice Stewart, "know it when they see it."[125] This, however, provides little guidance for bankruptcy judges trying to resolve difficult problems in complex cases.

2. Consent and Economic Stakes

Apart from indeterminacy, consent presents other problems: whose consent (or dissent) counts, and how do we decide? The *Jevic* majority spoke of "affected" creditors, suggesting that we should care about the consent of parties with a substantive economic stake in the outcome.[126] It was not hard to see that the creditors in *Jevic* were "affected" by the structured dismissal there: no one disputed their priority, or the fact that estate property (proceeds of the fraudulent transfer settlement) would have "skipped" over that priority had the Court upheld the lower courts. The *Jevic* drivers were, in the vernacular, "in the money." But that will not always be so clear.

In *In re Petersburg Regency LLC*,[127] for example, the Bankruptcy Court for the District of New Jersey concluded that objections of shareholders of an insolvent corporation did not count.[128] The *Petersburg* debtor was a hotel that suffered hurricane damage; its only asset was about $9 million in insurance proceeds.[129] The senior creditors were undersecured, meaning their liens fully encumbered the assets. They and all non-insider creditors agreed to a structured dismissal in

125. Jacobellis v. Ohio, 378 U.S. 184, 197 (1964) (Stewart, J., concurring) ("I shall not today attempt to further define the kinds of material I understand to be embraced within that shorthand description [hard-core pornography]; and perhaps I could never succeed in intelligibly doing so. But I know it when I see it . . . .").

126. Czyzewski v. Jevic Holding Corp., 580 U.S. __, 137 S. Ct. 973, 983 (2017).

127. 540 B.R. 508 (Bankr. D.N.J. 2015).

128. *Id.* at 531.

129. *Id.* at 532–33.

which the senior creditors shared their recovery with junior creditors, but not with the debtor's principals.[130] "Unlike *Jevic*," the court noted,

> [N]o class of creditors—priority or otherwise—is being "skipped" and there is unanimous support for the Settlement among the Debtor's non-insider creditors. Only the [equity owners], as insiders, oppose the Settlement and Structured Dismissal, as their interests are directly opposed to the non-insider creditors. Thus, this Court finds and determines that the Settlement and Structured Dismissal is plainly in the best interests of the Debtor's creditors and the estate.[131]

Because the *Petersburg* court concluded that the principals were "out of the money," their objections would not prevent the court from approving the structured dismissal.[132]

This, however, begs two questions. First, who gets to decide that the objectors were out of the money? In many cases, it will not be difficult to know, because the debtor will obviously be insolvent. But valuation is often one of the more difficult and disputed challenges bankruptcy courts face. Because reorganization may seek to reallocate the future value of a business to today's stakeholders, the risks and costs of error are high. Although *Jevic* was not a reorganization, the senior creditors there could plausibly have claimed that the mid-priority drivers were out of the money, because the debtor's assets were fully encumbered. Absent the fraudulent transfer claims asserted in the LBO suit, who would have been in a position to challenge that?

Second, why are economic stakes the only ones that matter? For some years, a small group of academics argued that bankruptcy should be understood as involving more than simply economic adjustments: it should advance other normative values.[133] Courts have largely ignored this approach, at least as a substantive matter. Indeed, even when the Bankruptcy Code specifically designates a non-economic actor—the United States Trustee (UST)—to monitor and challenge matters in Chapter 11 cases, judges are skeptical. In *In re Buffet Partners*,[134] for example,[135] the parties sought a structured dismissal for the reasons one

---

130. *Id.* at 545.

131. *Id.*

132. *Id.* at 543.

133. *See, e.g.*, Donald R. Korobkin, *Bankruptcy Law, Ritual, and Performance*, 103 COLUM. L. REV. 2124, 2150 (2003) (discussing "[b]ankruptcy law's struggle to manage a normative 'departure' without normative 'offense'").

134. No. 14-30699-HDH-11, 2014 WL 3735804 (Bankr. N.D. Tex. July 28, 2014).

135. *Jevic*, 137 S. Ct. at 985 (citing *In re Buffet Partners*, 2014 WL 3735804, at *1).

would expect: the debtor's assets had been sold, and there was only a pot of cash to distribute among creditors.[136] The creditors' committee and debtor agreed to settle and dismiss the case and sent notice of the proposed structured dismissal to creditors.[137] Only the UST objected.[138] In approving the structured dismissal over the UST's objection, the court observed:

> It is important to emphasize that not one party with an economic stake in the case has objected to the dismissal in this manner. While this fact is not outcome determinative, it is still worthy of consideration. All of the following parties affirmatively assent to the proposed dismissal: the Debtor, the Lender, and the Committee, which represents a large portion of the unsecured debt. The UST is the sole objecting party.[139]

The intuition behind *Buffet Partners* is easy to understand: Chapter 11 is a system to adjust economic losses, and, except when acting in a pecuniary capacity, the government should not impede an efficient mechanism for doing that. Yet, simply saying that we should consider only the objections of economic stakeholders ignores the reality that Chapter 11 is a hybrid, public-private process. Because it occurs in and around courts, it is (or should be) more than simply a negotiated reallocation of wealth. How to determine which economic stakes count for purposes of determining consent, and whether (or to what extent) the consent of non-economic participants should count, will be difficult questions going forward. *Jevic* tells us nothing about this.

---

136. *In re Buffet Partners*, 2014 WL 3735804, at *1 ("There now remains a fixed sum of money to be distributed.").

137. *Id.* ("The Settlement Motion was noticed out . . . .").

138. *Id.* ("The United States Trustee was the only party to object."). The status of the UST is somewhat unusual. Its officers ("trustees" and their assistants) are public officials who "protect the integrity of the bankruptcy system." *In re* Youk-See, 450 B.R. 312, 323 (Bankr. D. Mass. 2011); *see also* Morgenstern v. Revco D.S., Inc. (*In re* Revco D.S., Inc.), 898 F.2d 498, 500 (6th Cir. 1990) (describing the United States trustee as "a watchdog rather than an advocate" protecting the public interest). The program's director, Clifford White, recently testified before Congress to the ostensible non-economic interests that the UST represents. *Director Clifford J. White III of the Executive Office for U.S. Trustees Testifies Before the House Judiciary Committee Subcommittee on Regulatory Reform, Commercial & Antitrust Law at a Hearing on Oversight of U.S. Trustee Program*, U.S. DEP'T OF JUSTICE (June 8, 2017), https://www.justice.gov/opa/speech/director-clifford-j-white-iii-executive-office-united-states-trustees-testifies-us-hous-0 [https://perma.cc/V8Z2-5JUU] ("The Jevic case stands as a good example of the role the USTP can play in reorganization cases. As the only neutral party and one without a pecuniary interest, we are able to ensure that the provisions of the Bankruptcy Code are followed by all parties to the case.").

139. *In re Buffet Partners*, 2014 WL 3735804, at *4.

3. *Consent in Aggregate Litigation*

Courts concerned about consent in bankruptcy may also look to the standards that apply to the settlement of aggregate litigations. The American Law Institute's *Principles of the Law: Aggregate Litigation* (Principles) defines an "aggregate lawsuit" as "a single lawsuit that encompasses claims or defenses held by multiple parties or represented persons."[140] These include "mass-tort actions, class actions, derivative lawsuits, actions naming multiple conspirators, and inventory settlements."[141] The Principles recognize that "[b]ankruptcy proceedings also meet this definition and provide helpful examples and lessons,"[142] but do not address them specifically.[143]

Although the Principals do not formally apply to Chapter 11 cases, it is easy to see the analogy when assessing structured dismissals. Aggregate lawsuits and Chapter 11 cases both involve many claimants asserting claims against a common defendant or debtor. The debtor in *Jevic*, for example, indicated that it believed it had between 5,001 and 10,000 creditors, and this was not an especially large case, as large cases go.[144] Both likely involve settlements rather than adjudicated resolution to bring closure to underlying disputes. Both require party consent to settle, although individuated, affirmative evidence of consent may be costly and implausible to obtain.[145]

---

140. PRINCIPLES OF THE LAW: AGGREGATE LITIGATION § 1.02(a) (AM. LAW INST. 2010).

141. *Id.* § 1.02 cmt. a.

142. *Id.*

143. The ALI did not seek to "set out principles designed to govern these proceedings" for the rather odd reason that bankruptcy is "regulated by the Federal Rules of Bankruptcy Procedure." *Id.* The stated reason makes no sense. While there may be cause to treat Chapter 11 cases differently from the aggregate proceedings that concerned the ALI, the presence or absence of rules of bankruptcy procedure could not matter. Among other reasons, those rules largely incorporate the Federal Rules of Civil Procedure, which apply to "adversary proceedings" and (to a more limited extent) "contested matters." *See* FED. R. BANKR. P. 7001 & 9014(c) (defining scope of adversary proceedings and contested matters in bankruptcy). Moreover, the Federal Rules of Bankruptcy Procedure specifically incorporate Federal Rule of Civil Procedure 23 on class actions, meaning that the mechanics of aggregate litigation are formally subsumed in Chapter 11 reorganization. FED. R. BANKR. P. 7023.

144. Voluntary Petition at 1, *In re* Jevic Holding Corp., No. 08-11006 (BLS) (Bankr. D. Del. May 20, 2008).

145. Chapter 11 cases are more like "non-class" aggregate lawsuits than class actions, however, because creditors' claims will arise from different types of facts, involve different questions of law, and so make class certification implausible under Federal Rule of Civil Procedure 23. *See* Alan N. Resnick, *Bankruptcy as a Vehicle for Resolving Enterprise-Threatening Mass Tort Liability*, 148 U. PA. L. REV. 2045, 2059 (2000) ("The classification of claims under a Chapter 11 plan differs significantly, however, from the creation of a class for Rule 23 class action purposes.").

The "non-class" aggregate lawsuit (or "quasi-class action"[146]) has become an important and controversial substitute for formal class actions. Non-class aggregate litigations present process problems similar to those involved in structured dismissals. In theory, a court may not approve the settlement of a non-class aggregate lawsuit unless all parties consent.[147] In practice, however, the settlements of the Zyprexa[148] and Vioxx[149] litigations show that crafty lawyers have developed techniques to make it virtually impossible for their clients to resist.[150]

---

146. Linda S. Mullenix, *Dubious Doctrines: The Quasi-Class Action*, 80 U. CIN. L. REV. 389, 394 (2011) (arguing that a quasi-class action is "a court's short-hand description for collective litigation where numerous plaintiffs are consolidated under simple joinder rules"); *see also* McKenzie, *supra* note 17, at 1016 ("In the quasi-class action, plaintiffs who pursue claims against a defendant are drawn into an aggregate proceeding in a single forum that effectively monopolizes the resolution of their claims. . . . Like a bankruptcy case, the quasi-class action is held together by a centralized forum containing individual claims—claims that are not fused into a single collective governed by a representative with delegated authority (as in a class action).").

147. *See* Nancy J. Moore, *The Case Against Changing the Aggregate Settlement Rule in Mass Tort Lawsuits*, 41 S. TEX. L. REV. 149, 165 (1999) ("As interpreted by courts, however, the aggregate settlement rule forbids lawyers from entering settlement over the objection of any plaintiff, even when that plaintiff has agreed in advance to be bound by a vote of a majority or a supermajority."); Nancy J. Moore, *The Absence of Legal Ethics in the ALI's* Principles of the Law of Aggregate Litigation*: A Missed Opportunity—and More*, 79 GEO. WASH. L. REV. 717, 718 (2011) (discussing a proposed change to the ethics rules that would allow claimants to "agree in advance, under certain circumstances, to be bound by a majority vote in favor of a particular settlement"). *But see* PRINCIPLES OF THE LAW: AGGREGATE LITIGATION, *supra* note 140, § 3.17 (providing the requirements for using informed consent to allow multiple clients to use a substantial majority vote to accept aggregate settlements).

148. *See In re* Zyprexa Prods. Liab. Litig., 424 F. Supp. 2d 488, 490 (E.D.N.Y. 2006). The *Zyprexa* settlement was the result of extensive multi-district litigation across the United States for personal injuries against the manufacturer of Zyprexa, a prescription drug used to treat schizophrenia. *Id.* In *Zyprexa*, a "contractual nonclass aggregate settlement" occurred, which Professor Mullenix argues is "a concept that deliberately resonates in the familiar language of the class action while simultaneously rejecting the class concept in favor of a unit of 'aggregate claims' resolved instead by contract." *See* Linda S. Mullenix, *Aggregate Litigation and the Death of Democratic Dispute Resolution*, 107 NW. U. L. REV. 511, 541 (2013). From this emerged what she calls the "judicial invention" of the "quasi-class action," or simply the "logical extension of, and corollary to, the contractual nonclass aggregate settlement." *Id.* at 542.

149. Settlement Agreement Between Merck & Co., Inc. and the Counsel Listed on the Signature Pages Hereto (Nov. 9, 2007), http://www.officialvioxxsettlement.com/documents/Master%20Settlement%20Agreement%20-%20new.pdf [https://perma.cc/83P6-A72R].

150. As Erichson and Zipursky explain, the lawyers in *Vioxx* made it very difficult for the clients to resist settling for two reasons:

> First, under the terms of the agreement, for a lawyer to participate in the deal—that is, for *any* of the lawyer's clients to avail themselves of the settlement offer—the lawyer was required to recommend the settlement to *all* of the lawyer's eligible clients. Second, if any clients decided not to participate in the settlement, the lawyer was required to withdraw from representing the nonsettling clients. A client wishing to decline the settlement, in other words, faced the prospect of losing her lawyer and finding that every other lawyer handling Vioxx claims was similarly unavailable.

In the quasi-class action, consent will likely be manifest by counsel, who will represent that their clients have agreed to the settlement. Assuming the lawyers actually have this authority, it will be fairly easy for the court to approve the settlement. This may not be a safe assumption, however, because it is not clear how a court can know that all plaintiffs have in fact consented or have done so on an informed basis. Critics worry that the rise of these non-class lawsuits excessively empowers lawyers, at the risk of harming their clients.[151]

In form, this resembles the problem in *Jevic*. There, counsel to the creditors' committee had negotiated the structured dismissal with the debtor and senior creditors. The committee theoretically represented all unsecured creditors—including the drivers—but its counsel could be paid only if the bankruptcy court approved the structured dismissal. In fact, however, the drivers' objection—and their retention of separate counsel—indicated that the drivers did not consent. But what if the drivers had not had separate counsel or had failed to assert a formal objection? Should the bankruptcy judge have inferred from the presence of their priority claims that they should have objected, that their silence was a false negative? Or should the judge infer from silence that they consented to the settlement—even though it was designed to strip their right to recover?

The Principles attempt to manage these problems through the lens of legal ethics. The Principles provide, for example, that counsel must inform clients of the financial effects of the settlement on both the clients *and* counsel:

> A lawyer or group of lawyers who represent two or more claimants on a non-class basis may settle the claims of those claimants on an aggregate basis provided that each claimant gives informed consent in writing. Informed consent requires that each claimant be able to review the settlements of all other persons subject to the aggregate settlement or the formula by which the settlement will be divided among all claimants. Further, informed consent requires that the total financial interest of claimants' counsel be disclosed to each claimant.[152]

Erichson & Zipursky, *supra* note 18, at 266. Nearly all plaintiffs in fact agreed. *Id.* ("One year later, the Claims Administrator reported that over 99.79% of the eligible claimants had enrolled.").

151. *Id.* at 317 (criticizing non-class settlements because they empower lawyers and "the empowerment of the lawyer is not purely in service of a better deal for clients. In this setting, the lawyer acquires more money than any of her clients").

152. PRINCIPLES OF THE LAW: AGGREGATE LITIGATION, *supra* note 140, § 3.17(a).

The structured dismissal in *Jevic* may have flunked the Principles' standards because it is not clear whether counsel adequately disclosed its financial interest to creditors.[153] Nor is it clear how they could have done so. If by "counsel" we mean counsel to the settling parties—the debtors, senior lenders, and creditors' committee—then their fees may not be known until after the underlying matters are resolved because these professionals are paid by the bankruptcy estate. While it may be possible to estimate their fees along the way, they cannot be paid until the court approves a formal request for payment through a fee application, which may be an hourly rate not known until at or near the time of the final hearing.[154] In aggregate litigation, by contrast, it appears that counsel are often paid a percentage of the settlement's value, which can be estimated ex ante.[155] There is no obvious reason professional fees in bankruptcy could not be tailored to satisfy the Principles' standards. Current practice, however, would not fit well with them.

4. Consent and Due Process

Behind the ALI's concerns about legal ethics are concerns about due process. The ALI recognizes that the legitimacy of consensual resolutions of aggregate litigation "is a creature of due process . . . . A party can be bound [to the settlement] when given notice and an opportunity to be heard."[156] Although the Principles do not cite it, the obvious reference here is to *Mullane v. Central Hanover Bank & Trust Co.*,[157] which applies in bankruptcy and in all aggregate litigations.

153. The Order approving the Dismissal Motion approves the payment of $200,000 in professional fees of the creditors' committee, Dismissal Order, *supra* note 5, ¶ 8, but the Dismissal Motion itself indicates that those fees were subject to future determination, *see* Dismissal Motion, *supra* note 45, ¶ 17 (directing professionals to file fee applications after entry of the Dismissal Order).

154. *See* Stephen J. Lubben, *The Chapter 11 Financial Advisors*, 28 EMORY BANKR. DEV. J. 11, 13 (2011) ("[U]nder § 330 of the Bankruptcy Code and under Federal Rule of Bankruptcy Procedure 2016, all professionals retained by either the debtor or an official committee (most often a creditors' committee) must file fee applications with the court before they can be paid from estate funds.").

155. Charles Silver & Geoffrey P. Miller, *The Quasi-Class Action Method of Managing Multi-District Litigations: Problems and a Proposal*, 63 VAND. L. REV. 107, 109 (2010) ("Over the long history of MDLs [multidistrict litigations], judges have awarded lead attorneys billions of dollars in fees and cost reimbursements. Typically, fee awards range from 4 percent to 6 percent of total recoveries, but smaller and larger percentages can be found. This practice supposedly rests on the common fund doctrine, a creature of the law of restitution which undergirds fee awards in class actions.").

156. PRINCIPLES OF THE LAW: AGGREGATE LITIGATION, *supra* note 140, § 1.05 cmt. c.

157. 339 U.S. 306 (1950).

In *Mullane*, administrators of a trust sought a declaratory judgment to determine the rights of beneficiaries with respect to a trust corpus. Although the administrators had the names and addresses of some beneficiaries, they only published notice of the declaratory judgment action in newspapers, notice that the Supreme Court viewed as "[no] more than a feint."[158] The Supreme Court held that "[a]n elementary and fundamental requirement of due process in any proceeding which is to be accorded finality is notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections."[159]

The issue before the Court in *Mullane* involved two aspects of the constitutional requirement of notice: (1) what type of notice does due process require, and (2) who must receive it?[160] The opinion is most famous for the first—it must be sufficiently informative to enable the recipient to know that a court is about to do something important. The second, however, focuses on the characteristics of the recipients, and the lengths to which the administrators had to go to provide individualized notice. As Tobias Wolff has pointed out, *Mullane* seems best understood as asking courts to engage in a cost-benefit analysis, weighing the substantive stakes of potential recipients against the costs of providing individualized notice.[161]

Mullane's sensitivity to cost-benefit analysis seems especially important in Chapter 11, where the opinion has been relevant for determining the time and expense to which a corporate debtor must go to identify creditors, and provide individualized notice of important matters in the case, in particular the "bar date," after which claims against the

158. *Id.* at 315; *see also id.* at 307–10 (describing the manner in which notice was required to be, and was, given).

159. *Id.* at 314.

160. Tobias Barrington Wolff, *Federal Jurisdiction and Due Process in the Era of the Nationwide Class Action*, 156 U. PA. L. REV. 2035, 2098 (2008).

161. *Id.* at 2099–100 ("The less definite, concrete, and extant a person's property interest, the less urgent is the need for providing individualized process to absentees, particularly when the proceeding is structured so as to provide additional assurance that those interests will be safeguarded in the class member's absence. Although not making the point explicit, the Court suggested a sliding-scale approach to the analysis, with those interests that 'are so remote as to be ephemeral' requiring no individualized process at all." (quoting *Mullane*, 339 U.S. at 317)). Thus, "[a] creditor's identity is 'reasonably ascertainable' if that creditor can be identified through 'reasonably diligent efforts.'" Chemetron Corp. v. Jones, 72 F.3d 341, 346 (3d Cir. 1995) (quoting Mennonite Bd. of Missions v. Adams, 462 U.S. 791, 798 n.4 (1983)). "Reasonable diligence," in turn, "does not require 'impracticable and extended searches . . . in the name of due process.'" *Id.* (quoting *Mullane*, 339 U.S. at 317).

debtor may not be asserted.[162] Concerns about notice in a Chapter 11 case dominate mass tort bankruptcies, such as those involving asbestos, where the general harm may be known at the time of bankruptcy, but the identities of victims are unknown—and unknowable—because the damage may take many years to manifest itself.[163] The Second Circuit's recent decision reversing the lower court in the General Motors ignition switch litigation because the debtor knew the identities of car purchasers and nonetheless failed to send them notice is a reminder that courts must take *Mullane*'s due process values seriously, even in bankruptcy.[164]

"Due process" is, however, a standard that is both grand and vague. It purports to instill confidence in the legitimacy of legal process, yet is quite hazy about how to do so in any given case. We tend to think of due process as involving binary disputes, in particular efforts by government to take life, liberty, or property. In Chapter 11 bankruptcy, however, the role of government is opaque and diffuse: bankruptcy judges are obviously government actors, but they engage in a deliberately complex set of interactions with participants and their representatives in ways that make it hard to determine—or to justify spending the money to determine—whether due process has (or has not) been satisfied. In other words, due process may be intimately related to consent, but it provides little concrete guidance on how to identify consent in corporate reorganizations.[165]

---

162. As the Third Circuit Court of Appeals has explained:

> Precedent demonstrates that what is required is not a vast, open-ended investigation. . . . The requisite search instead focuses on the debtor's own books and records. Efforts beyond a careful examination of these documents are generally not required. Only those claimants who are identifiable through a diligent search are "reasonably ascertainable" and hence "known" creditors.

See Chemetron Corp., 72 F.3d at 346–47 (citations and footnotes omitted).

163. These challenges have led to versions of what Bookman and Noll call "ad hoc procedure," which in Chapter 11 takes the form of a "channeling injunction," forcing asbestos victims to "channel" their claims against asbestos makers that have gone into bankruptcy through the Chapter 11 process—and specialized trusts created in the reorganizations—which seek to fully and finally resolve the claims. *See* Pamela K. Bookman & David L. Noll, *Ad Hoc Procedure*, 92 N.Y.U. L. REV. 767, 771–74 (2017) (discussing procedure for creating channeling injunction in Chapter 11 cases).

164. *See* Elliott v. Gen. Motors LLC (*In re* Motors Liquidation Co.), 829 F.3d 135 (2d Cir. 2016).

165. Jonathan C. Lipson, *Debt and Democracy: Towards a Constitutional Theory of Bankruptcy*, 83 NOTRE DAME L. REV. 605, 669–70 (2008). For a discussion of the role of judges in Chapter 11 cases generally, see Melissa B. Jacoby, *What Should Judges Do in Chapter 11?*, 2015 U. ILL. L. REV. 571.

B. Consent and Closure

Concerns about due process values sharpen a tension embedded in *Jevic*. Chapter 11 seeks both to maximize recoveries and to provide some baseline procedural protections. Sometimes these goals are consonant; sometimes—as in *Jevic*—they are not. The best argument for privileging the distributive over the procedural—the aspiration of the senior creditors in *Jevic* and often elsewhere—is closure: bringing the case efficiently to an end. Closure is, for example, often the strongest argument for quasi-class action settlements outside of bankruptcy.[166] By inducing (or coercing) clients to settle, the quasi-class settlement produces finality that benefits the parties and the judicial system.[167]

Finality is also a key motivation for using Chapter 11. A confirmed plan can result in the discharge of debt, perhaps the greatest finality a corporate debtor can hope to achieve with respect to its stakeholders.[168] In theory, a discharge is not available if a case is dismissed.[169] The structured dismissal in *Jevic*, for example, did not contain an explicit discharge. But it did not need one in order to achieve the same result. Because it sought a final distribution of all of the debtor's assets, any post-dismissal litigation against it would have been pointless: after dismissal, Jevic would have no assets, and thus be judgment proof. In the unlikely event the debtor did acquire property after dismissal, the structured dismissal apparently preserved the liens and priority of CIT.[170] Because it was undersecured, its lien would attach to any such property, further reducing the likelihood that creditors could collect from Jevic post-dismissal. Because the debtors in *Jevic* were entities, the shareholders (Sun) would not be liable personally for their debts, even after dismissal. The debtors would simply dissolve under applicable state law, a natural death that leaves unpaid creditors, such as the drivers, no practical recourse.

---

166. Erichson & Zipursky, *supra* note 18, at 267 ("[M]ass tort lawyers largely abandoned any hope that settlement class actions would be the key to finding closure. Nonclass aggregate settlements have filled this void . . . .").

167. *Id.* at 268 ("[C]losure is what defendants demand, and it is what plaintiffs need to offer if they are to maximize settlement value. The Vioxx Settlement Agreement stands as the most prominent real-life solution to the intractable problem of achieving closure in a mass tort settlement without using the class action rule and without resorting to bankruptcy.").

168. 11 U.S.C. § 1141 (2012).

169. In general, corporations cannot obtain a discharge absent confirmation of a plan of reorganization. *Id.* § 1141(d). A discharge is not, for example, available to a corporation that liquidates under Chapter 7 of the Bankruptcy Code. *Id.* § 727(a)(1).

170. *See* Dismissal Order, *supra* note 5.

Moreover, CIT and Sun were released from liability in connection with the LBO—giving them closure. For them, it appears that this was a central feature of the deal. Yet, the truck drivers had objected, leaving the question whether they could continue to sue CIT and Sun in New Jersey state court under New Jersey law after the dismissal. Absent the "structure" of the dismissal in *Jevic*—the release given to Sun and CIT—it appears that they could have. But the deal there sought to take this away from them. This would have violated the letter of the law governing non-class aggregate settlements, where each claimant must signal consent.[171] At least so far as the lower courts in *Jevic* were concerned, bankruptcy was different. The efficiency demands of Chapter 11 practice—resolving the case—were to the lower courts more powerful than procedural protections for the drivers.

III. PROCESS VALUES

Although the *Jevic* majority disagreed with the lower courts, they did not tell us what constitutes consent in Chapter 11. What, then, to do? This Part argues that the reasoning and implications of the majority opinion reflect values of process-quality that courts should consider proxies for consent. Courts can, in other words, minimize the risk of false negatives and other consent errors by taking seriously *Jevic*'s views about participation, predictability, and procedural integrity.

A. Participation

To understand *Jevic*'s process values, consider what was at stake. If the Court had affirmed the Third Circuit, it is likely that structured dismissals would increasingly displace plans of reorganization as the principal mechanism to exit Chapter 11. By reversing, *Jevic* thus preserved the role that plans play in reorganization. This, however, raises a question: what is so great about plans? They can be expensive, complex, and cumbersome.[172] Major stakeholders have for many years sought to reduce their costs, including through the advent of the

---

171. Erichson & Zipursky, *supra* note 18, at 269 ("Section 3.17(b) of [PRINCIPLES OF THE LAW: AGGREGATE LITIGATION] presents a legal device designed to allow plaintiffs' lawyers to bind clients to a group settlement. Although the proposal would require that clients as a group ratify the settlement by supermajority vote, it would bypass the requirement of individual consent. . . . Consent—not closure—determines legitimacy.").

172. *See, e.g.*, Lynn M. LoPucki & Joseph W. Doherty, *Rise of the Financial Advisors: An Empirical Study of the Division of Professional Fees in Large Bankruptcies*, 82 AM. BANKR. L.J. 141 (2008) (discussing Chapter 11 costs).

"prepackaged" plan and the rise of all-assets sales under section 363.[173] The structured dismissal was, to many, simply the next logical step in the efficiency-minded evolution of Chapter 11 practice.

While plans can be costly, one of their principal virtues—threatened by the *Jevic* structured dismissal—is stakeholder participation. At a high level of generality, participation is a key characteristic of the U.S. legal system.[174] Among other things, participation through judicial process promotes the legal "accuracy" of outcomes,[175] the dignity of those aggrieved or accused of wrongdoing,[176] and the "legitimacy" of outcomes.[177] Moreover, participation guided by an absolute priority structure may increase the likelihood of efficiency gains.

Congress designed the Chapter 11 plan process to have two key participatory features:

- *Disclosure*. Information is a predicate to both participation and consent. Chapter 11 solves for this by providing that a plan cannot be confirmed unless it is supported by a "disclosure statement." A disclosure statement is a document somewhat like a securities prospectus, which provides creditors with "adequate information"

---

173. *See, e.g.*, Stephen H. Case & Mitchell A. Harwood, *Current Issues in Prepackaged Chapter 11 Plans of Reorganization and Using the Federal Declaratory Judgment Act for Instant Reorganizations*, 1991 ANN. SURV. AM. L. 75, 83–84 (1992) ("Prepackaged plans have . . . major advantages over the 'classic' chapter 11 process: (i) a fairly high degree of assurance about the success and brevity of the proceeding; (ii) lower administrative costs . . . .").

174. "[T]he distinguishing characteristic of adjudication lies in the fact that it confers on the affected party a peculiar form of participation in the decision, that of presenting proofs and reasoned arguments for a decision in his favor." Lon Fuller, *The Forms and Limits of Adjudication*, 92 HARV. L. REV. 353, 364 (1978).

175. Susan P. Sturm, *The Promise of Participation*, 78 IOWA L. REV. 981, 985 (1993) ("Adversarial presentation by parties' lawyers enhances the likelihood of reaching a correct decision.").

176. *Id.*

177. Lawrence B. Solum, *Procedural Justice*, 78 S. CAL. L. REV. 181, 274 (2004) (noting "a core right of participation is essential for the legitimacy of adjudication"); Daniel Markovits, *Adversary Advocacy and the Authority of Adjudication*, 75 FORDHAM L. REV. 1367, 1371–76 (2006) (arguing legitimacy of government institutions depends on legitimacy with respect to both underlying "theoretical model," with "emphasis on abstract propositions about justified political power," and "practical approach," with emphasis on "consequences of actual engagement" and impact of "participation . . . on the . . . attitudes of the participants"); Jerry L. Mashaw, *The Supreme Court's Due Process Calculus for Administrative Adjudication in* Mathews v. Eldridge*: Three Factors in Search of a Theory of Value*, 44 U. CHI. L. REV. 28, 49–52 (1976) (linking the right to participate personally in adjudication with individuals' dignity); Robert S. Summers, *Evaluating and Improving Legal Processes—A Plea for "Process Values,"* 60 CORNELL L. REV. 1 (1974). *But cf.* Louis Kaplow, *Information and the Aim of Adjudication: Truth or Consequences?*, 67 STAN. L. REV. 1303, 1362 (2015) ("[P]articipation and other process values may have consequences that are relevant to social welfare, but they do not systematically relate to the truth or to the often-present divergence between the pursuit of truth and of consequences in legal system design.").

about the plan and the debtor sufficient to enable them to vote for or against it.[178] As a practical matter, the hearing on the motion to approve the disclosure statement will often channel—and consensually resolve—objections to the plan itself.

- *Voting*. Short of a state-contingent contract, the best evidence of participation and consent to resolve a Chapter 11 case will be a vote. Chapter 11 provides that a plan must have a minimum level of stakeholder support, generally speaking two-thirds in dollar amount and more than half in number of creditors entitled to vote.[179] Outside of Chapter 11, debt obligations and associated property rights (e.g., liens) can be modified only if all (or almost all) creditors so agree.[180] In Chapter 11, by contrast, the plan proponent (presumptively the debtor's management) places creditors in classes, and then proposes "treatment" for those classes (e.g., payment of a percentage of the claim in cash, issuing new securities, etc.), which creditors accept or reject by super-majority vote.[181] The logic of Chapter 11 substitutes participation through the creditor franchise for strict recognition of all pre-bankruptcy entitlements.

Because structured dismissals involve neither a disclosure statement nor voting, the structured dismissal approved by the lower courts would have compromised both. But, the economic pressures that have led to the advent of structured dismissals are real and often conflict with participation as a process-value. Thus, the important questions are why participation is a value in *Jevic*, and how it should be understood in the resource-constrained environment of Chapter 11.

1. Sales v. Plans—Unfinished Chrysler *Business?*

Participation, like all process values, is not free, and practice under Chapter 11 has sought to cut these costs through the increased use of all-

178. 11 U.S.C. § 1125(b) (2012). "Adequate information" is defined as "information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records . . . that would enable . . . a hypothetical investor of the relevant class to make an informed judgment about the plan." *Id.* § 1125(a).

179. *Id.* § 1126(c). This glosses over much complexity not especially important here, including that creditors are classified and vote by class. *Id.* § 1122(a).

180. *But cf.* Marblegate Asset Mgmt., LLC v. Educ. Mgmt. Corp., 846 F.3d 1 (2d Cir. 2017) (permitting modifications under Trust Indenture Act); *id.* at 11 n.7 (citing Mark J. Roe, *Chaos and Evolution in Law and Economics*, 109 HARV. L. Rev. 661 (1996)).

181. 11 U.S.C. § 1123(a)(1) (requiring plan to "designate, subject to section 1122 of this title, classes of claims").

assets sales. Section 363 of the Bankruptcy Code permits a debtor to do so outside of a reorganization plan, and this is how many firms in fact reorganize.[182] "In modern bankruptcy practice," the Third Circuit recently observed, a sale under section 363 "is the tool of choice to put a quick close to a bankruptcy case. It avoids time, expense, and, some would say, the Bankruptcy Code's unbending rules."[183] Under such a sale, a debtor may sell all of its assets, as a whole or free from weaker parts.

The all-assets sale was notoriously the path that the debtors in both *In re Chrysler LLC*[184] and *In re General Motors Corp.*[185] followed. In *Chrysler*, the United States and Canadian governments facilitated negotiations between Fiat and Chrysler to produce a sale agreement dated April 30, 2009, the same day that Chrysler filed its Chapter 11 petition.[186] Under similar government supervision, General Motors filed its Chapter 11 petition on June 1 and, on the same day, filed its proposed sale transaction under section 363.[187]

The "reorganizations" were effected by selling all assets to purchasers owned by employees and the government, which had financed the cases. Creditors of the "old" automakers would still have claims against the debtors—but they would not receive shares of the purchaser, the future value of the automakers. To many, this offended horizontal equity.[188]

---

182. *Id.* § 363(b) ("The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate . . . ."). *See generally* Brubaker & Tabb, *supra* note 16, at 1375 ("Such an internal boot-strap reorganization [has been] on the decline, and many reorganizations are now accomplished through a relatively expeditious going-concern sale of the debtor's business and assets to a third-party purchaser, with a subsequent distribution of the proceeds to creditors and shareholders in accordance with their relative priority rights."); Casey, *supra* note 13, at 760 ("The norm for today's corporate reorganization is a quick going-concern sale.").

183. *In re* ICL Holding Co., 802 F.3d 547, 549 (3d Cir. 2015).

184. 576 F.3d 108 (2d Cir.), *vacated as moot sub nom*. Ind. State Police Pension Tr. v. Chrysler LLC, 558 U.S. 1087 (2009) (mem.).

185. 407 B.R. 463 (Bankr. S.D.N.Y. 2009).

186. *In re Chrysler*, 576 F.3d at 111–12.

187. *See* Debtors' Motion Pursuant to 11 U.S.C. §§ 105, 363(b), (f), (k), & (m), & 365 & Fed. R. Bankr. P. 2002, 6004, & 6006, to (I) Approve (A) the Sale Pursuant to the Master Sale & Purchase Agreement with Vehicle Acquisition Holdings LLC, a U.S. Treasury-sponsored Purchaser, Free & Clear of Liens, Claims, Encumbrances, & Other Interests; (B) The Assumption & Assignment of Certain Executory Contracts & Unexpired Leases; & (C) Other Relief; & (II) Schedule Sale Approval Hearing, *In re* Gen. Motors Corp., 407 B.R. 463 (Bankr. S.D.N.Y. 2009) (No. 09-50026 (REG)), 2009 WL 1529573 [hereinafter GM Debtors' Motion].

188. Brubaker and Tabb, for example, understandably worry that the automaker cases are "clever and surreptitious end-runs around chapter 11's distributional norms." Brubaker & Tabb, *supra* note 16, at 1378. *Compare* Roe & Skeel, *supra* note 28, at 729 (arguing that the "Chrysler bankruptcy process used undesirable mechanisms that federal courts and Congress struggled for decades to

Justice Breyer's majority opinion in *Jevic* addressed the automaker cases only in passing, with a "cf." citation.[189] His opinion did, however, recognize that the logic underlying the automaker cases was procedurally problematic. "[T]he distributions at issue" in *Jevic*, he observed, "more closely resemble proposed transactions that lower courts have refused to allow on the ground that they circumvent the Code's procedural safeguards."[190] The "proposed transactions" he had in mind were all-assets sales that earlier decisions had rejected as disguised plans under the "*sub rosa* plan" doctrine.[191] A *sub rosa* plan is a "de facto plan of reorganization, which enables a debtor to restructure its debt while bypassing many of the Bankruptcy Code's fundamental creditor protections."[192]

The *sub rosa* plan doctrine has been diluted over time because courts like those in the automaker cases believe that reorganizations can more efficiently be effectuated by a sale rather than a plan.[193] Yet, earlier decisions—Justice Breyer relied on appellate court opinions from the early 1980s in the *In re Braniff Airways, Inc.*[194] and *In re Lionel Corp.*[195] bankruptcies—had worried that these sales could threaten the procedural protections of plans. In *Braniff*, the Fifth Circuit struck down a proposed sale of the debtor mid-way through the case that sought (1) to require

---

suppress"), *with* Stephen J. Lubben, *No Big Deal: The GM and Chrysler Cases in Context*, 83 AM. BANKR. L.J. 531, 532 (2009) (arguing that automaker bankruptcies "are entirely within the mainstream of chapter 11 practice for the last decade").

189. Czyzewski v. Jevic Holding Corp., 580 U.S. __, 137 S. Ct. 973, 986 (2017) (citing *In re Chrysler*, 576 F.3d at 118 ("[A]pproving a § 363 asset sale because the bankruptcy court demonstrated 'proper solicitude for the priority between creditors and deemed it essential that the [s]ale in no way upset that priority.'")).

190. *Id.*

191. *Id.* (citing Pension Benefit Guar. Corp., Cont'l Airlines, Inc. v. Braniff Airways, Inc. (*In re* Braniff Airways, Inc.), 700 F.2d 935, 940 (5th Cir. 1983) (prohibiting an attempt to "short circuit the requirements of Chapter 11 for confirmation of a reorganization plan by establishing the terms of the plan sub rosa in connection with a sale of assets")); Comm. of Equity Sec. Holders v. Lionel Corp. (*In re* Lionel Corp.), 722 F.2d 1063, 1069 (2d Cir. 1983) (reversing a Bankruptcy Court's approval of an asset sale after holding that section 363 does not "grant[] the bankruptcy judge carte blanche" or "swallow[] up Chapter 11's safeguards").

192. Del. Tr. Co. v. Energy Future Intermediate Holdings, LLC (*In re* Energy Future Holding Corp.), 527 B.R. 157, 168 (D. Del. 2015) (citing *In re* Marvel Entm't Grp., Inc., 222 B.R. 243, 251 (D. Del. 1998)), *aff'd sub nom. In re* Energy Future Holdings Corp., 648 F. App'x 277 (3d Cir. 2016), *cert. denied*, __ U.S. __, 137 S. Ct. 447 (2016) (mem.); *see also In re Chrysler*, 576 F.3d at 118.

193. *See In re Chrysler*, 576 F.3d at 118 ("Bankruptcy Judge Gonzalez found good business reasons for the Sale. The linchpin of his analysis was that the only possible alternative to the Sale was an immediate liquidation that would yield far less for the estate—and for the objectors.").

194. 700 F.2d 935 (5th Cir. 1983).

195. 722 F.2d 1063 (2d Cir. 1983).

creditors to vote in favor of any future plan of reorganization supported by a majority of the official unsecured creditors' committee; (2) to release the claims of all parties against the debtor, its secured creditors, and its officers and directors; and (3) to dictate certain economic terms of a future plan.[196] In *Lionel*, the Second Circuit did much the same, under similar circumstances, holding that a sale of a business as a going concern should occur under a plan, rather than through an earlier sale, absent emergency circumstances.[197]

Braniff and *Lionel* are vintage opinions, predating the rise of routine all-assets sales. In the past twenty years, courts appear to have become more comfortable with the expanding domain of reorganization-by-sale. This entails a shrinking role for plans.[198] A sale would, under post-*Braniff*/*Lionel* precedent, offend the *sub rosa* plan doctrine only if it "has the effect of dictating the terms of a prospective chapter 11 plan."[199] To be found to dictate the terms of a plan, the action "must either (i) dispose of all claims against the estate or (ii) restrict creditors' rights to vote."[200]

The structured dismissal in *Jevic* would appear to have flunked either the old or new versions of the *sub rosa* plan doctrine. As a practical matter, its "structure" would have disposed of all claims against the debtor because, as noted above, it distributed all assets of the debtors (cash) in the stipulated order of priority. It left behind a judgment-proof shell. And, because creditors have no vote on a structured dismissal, and no plan was to follow, it would have "restricted" the right to vote. Moreover, as in *Braniff*, the *Jevic* dismissal sought to eliminate creditors' ability to pursue those who may have harmed them or to negotiate different economic terms in the event a plan was ultimately proposed. To have approved the structured dismissal in *Jevic* would have been to virtually eliminate the last vestiges of the *sub rosa* plan doctrine.

---

196. *In re Braniff Airways*, 700 F.2d at 940 ("The debtor and the Bankruptcy Court should not be able to short circuit the requirements of Chapter 11 for confirmation of a reorganization plan by establishing the terms of the plan *sub rosa* in connection with the sale of assets. . . . In any future attempts to specify the terms whereby a reorganization plan is to be adopted, the parties and the district court must scale the hurdles erected in Chapter 11.").

197. *See In re Lionel*, 722 F.2d at 1063.

198. *See, e.g.*, *In re Chrysler*, 576 F.3d at 116 (approving all-assets sale but noting concerns about effect on plan-process protections); *In re* Gen. Motors Corp., 407 B.R. 463, 497 (Bankr. S.D.N.Y. 2009); J. Seth Moore & Vincent P. Slusher, *Bankruptcy Code Section 363 Sales: Trends and Opportunities*, NORTON BANKR. L. ADVISER, Sept. 2007, at 6, 9–10 (observing that "[t]he oversight and review of a § 363 sale is less than that of a plan confirmation because courts apply the amorphous and sometimes weak 'business judgment' standard to § 363 sales").

199. *In re* Capmark Fin. Grp., Inc., 438 B.R. 471, 513 (Bankr. D. Del. 2010).

200. *Id.*

Jevic did not forbid all-assets sales, however, or even hold that it was resurrecting the "old" version of the *sub rosa* plan doctrine. Rather, it may have been tending to unfinished business from the automaker bankruptcies. Objecting bondholders in *Chrysler* went all the way to the Supreme Court, after losing at every stage, including the Second Circuit. On a petition for certiorari they technically won: the Supreme Court vacated and remanded the case to the Second Circuit, without issuing a substantive opinion.[201] But by then it was a hollow victory, as the sale was already consummated and the appeal was moot.[202]

We can infer from *Jevic* that the majority understood that plans and their participatory mechanisms have value in the process which should not be abandoned lightly, even when corporate debtors are sold outside a plan. The Court's hurried treatment of *Chrysler* had left this question open because the sales there rendered the contours of a plan a fait accompli. The *Jevic* majority seems to be saying that even if we believe all-assets sales maximize value in Chapter 11, we cannot conclude the process by making final distributions without a plan or, absent a plan, "consent" or, absent consent, the more rigid absolute priority rule.

Jevic affirmed the participatory demands of plans by making clear that "consent" is the only exception to the Bankruptcy Code's priority structure in final distributions. Congress carefully and deliberately developed the procedural protections of plans in order to provide some assurance of consent to deviations from absolute priority. While consent outside a plan remains possible, it will for the reasons explained in Part II be difficult to show in many cases; judges should worry about false negatives (the absence of objections) as well as strategic dissents (e.g., grousing by those clearly out of the money). Plans are hardly perfect evidence of consent, but they provide a set of guardrails for those controlling the resolution of a Chapter 11 case. *Jevic* was the Court's way of reminding participants in this process that they cannot drive through or around those guardrails.

---

201. Ind. State Police Pension Tr. v. Chrysler LLC, 558 U.S. 1087 (2009).

202. The *Chrysler* Court told us virtually nothing about why it was reversing. The full opinion was a single paragraph:

> On petition for writ of certiorari to the United States Court of Appeals for the Second Circuit. Motion of Washington Legal Foundation, et al. for leave to file a brief as *amici curiae* granted. Petition for writ of certiorari granted. Judgment vacated, and case remanded to the United States Court of Appeals for the Second Circuit with instructions to dismiss the appeal as moot.

Chrysler LLC, 558 U.S. at 1087 (citing United States v. Munsingwear, Inc., 340 U.S. 36 (1950)). Citing *Munsingwear* means that the lower court decisions in *Chrysler* should have no precedential effect. A vacatur under *Munsingwear* "deprive[s] the [lower court's] opinion of precedential effect." O'Connor v. Donaldson, 422 U.S. 563, 577 n.12 (1975).

2. *Participation Through Bargaining and Markets*

Plans are not solely procedural mechanisms. In order to be confirmed, a plan must satisfy a number of substantive criteria that create opportunities for participation through bargaining and market processes. The "absolute priority rule" undergirding the *Jevic* opinion facilitates both.

The APR developed as a response to perceived abuses in the federal equity receiverships of the nineteenth and twentieth centuries. These cases were the forerunners of the modern Chapter 11 case—and of the problem in *Jevic*. The Court in the earlier cases worried that senior creditors and junior stakeholders (shareholders) would collude to "squeeze out" the general unsecured creditors.[203] In *Jevic*, the "middle" stakeholders being squeezed out were the drivers, due to their priority wage claims.

Although the APR is largely viewed as a distributive principle, it also has important participatory effects because it can force (or induce) plan bargaining.[204] Plans can be approved consensually, through sufficient supermajority class voting,[205] or non-consensually, if a class dissents.[206]

---

203. *Northern Pacific Railway Co. v. Boyd* firmly set out the absolute priority rule:

> [I]f purposely or unintentionally a single creditor was not paid, or provided for in the reorganization, [petitioner Boyd] could assert his superior rights against the subordinate interests of the old stockholders in the property transferred to the new company. They were in the position of insolvent debtors who could not reserve an interest as against creditors. Their original contribution to the capital stock was subject to the payment of debts. The property was a trust fund charged primarily with the payment of corporate liabilities. Any device, whether by private contract or judicial sale under consent decree, whereby stockholders were preferred before the creditor, was invalid. Being bound for the debts, the purchase of their property by their new company for their benefit, put the stockholders in the position of a mortgagor buying at his own sale. If they did so in good faith and in ignorance of Boyd's claim, they were none the less bound to recognize his superior right in the property, when, years later, his contingent claim was liquidated and established. That such a sale would be void, even in the absence of fraud in the decree, appears from the reasoning in Louisville Trust Co. . . . .

228 U.S. 482, 504–05 (1913) (citing Louisville Tr. Co. v. Louisville, New Albany & Chi. Ry. Co., 174 U.S. 674, 683 (1899)).

204. As Douglas Baird puts it:

> Whether a group consents depends on its rights under the plan versus the rights it would have if it refused to go along with the plan. The absolute priority rule is central to the law of corporate reorganizations because it is the source of substantive rights as well as the procedural protections that each participant in a reorganization enjoys. Parties can insist that the priority rights they enjoyed outside of bankruptcy be respected inside. Nevertheless, every junior party, including the shareholders, can invoke elaborate procedures before their rights are compromised. The absolute priority rule allows the senior parties to insist on full payment, but it also grants all junior parties those procedural protections necessary for a "just reorganization." Resolving this tension between substantive and procedural rights that began with *Boyd* remains central to answering the hard questions that arise under Chapter 11.

DOUGLAS G. BAIRD, THE ELEMENTS OF BANKRUPTCY 86 (4th ed. 2006). *See generally id.* at 225–82.

205. 11 U.S.C. § 1129(a) (2012).

In the event of dissent, section 1129(b)(2) of the Bankruptcy Code requires a court to impose absolute priority because it may only approve the plan if it does not "discriminate unfairly" and is "fair and equitable."[207] "Fair and equitable" means that if a class of unsecured creditors dissents, the plan may be confirmed if the dissenters are paid in full, or junior claimants' rights (e.g., shareholdings) are eliminated.[208]

Shareholders might, given this threat, walk away. But if they believe there is a brighter future for the debtor, they might not. Rather than lose their stake, junior claimants (equity) may protect their interest under the so-called "new value corollary."[209] A "new value" plan may be approved over a dissenting class vote, and junior stakeholders may retain an interest in the debtor, if they provide "new value" commensurate with the stake they retain. That is, if they "make a fresh contribution [they may] receive in return a participation reasonably equivalent to their contribution."[210]

The "new value" corollary may sound like a cockeyed bargain: why should creditors care if shareholders are wiped out? But it has the effect of forcing those most likely in historic control of the debtor (shareholders) either to propose a plan that in fact induces widespread support or to give up their junior stake. Chapter 11 practice sees this as a

---

206. *Id.* § 1129(b).

207. *Id.* Section 1129(b)(1) prohibits "unfair discrimination," which "assures fair treatment among classes of the same priority level." *See In re* SunEdison, Inc., 575 B.R. 220, 226 (Bankr. S.D.N.Y. 2017).

208. 11 U.S.C. § 1129(b)(2)(B)(ii) (permitting cramdown where "the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property"). *See generally* Bank of Am. Nat'l Tr. & Sav. Assoc. v. 203 N. LaSalle St. P'ship, 526 U.S. 434, 441–42 (1999).

209. *Case v. L.A. Lumber Products Co.*, 308 U.S. 106, 118 (1939), suggested that the objection of an impaired senior class does not bar junior claim holders from receiving or retaining property interests in the debtor after reorganization, if they contribute new capital in money or money's worth, reasonably equivalent to the property's value, and necessary for successful reorganization of the restructured enterprise.

> It is, of course, clear that there are circumstances under which stockholders may participate in a plan of reorganization of an insolvent debtor. . . . Where th[e] necessity [for new capital] exists and the old stockholders make a fresh contribution and receive in return a participation reasonably equivalent to their contribution, no objection can be made. . . . [W]e believe that to accord "the creditor his full right of priority against the corporate assets" where the debtor is insolvent, the stockholder's participation must be based on a contribution in money or in money's worth, reasonably equivalent in view of all the circumstances to the participation of the stockholder.

Id. at 121–22. It is worth noting that the Court has never affirmatively held that the new value corollary does (or does not) exist. *See LaSalle*, 526 U.S. at 443 ("We do not decide whether the statute includes a new value corollary or exception, but hold that on any reading respondent's proposed plan fails to satisfy the statute, and accordingly reverse.").

210. *Case*, 308 U.S. at 121.

bargaining opportunity: precisely because there may be (residual) going concern value that shareholders wish to preserve, they are likely to negotiate a plan attractive enough to unsecured creditors to obtain affirmative support sufficient to avoid cramdown.

But all of this glosses over difficult practical questions, in particular how much should the shareholders pay, and how do we figure that out? Consistent with *Jevic*, the Court has chosen a priority-enforcing rule that has important participatory implications, through the use of markets, which, in theory, reduce risks of seriously erroneous judicial valuations. In *Bank of America National Trust & Savings Ass'n v. 203 North LaSalle Street Partnership*,[211] the Court's last major foray into Chapter 11 jurisprudence before *Jevic*, Justice Souter held that valuation for these purposes must include market exposure—and not (only) judicial valuation.[212] Justice Souter's opinion there noted that when Congress drafted the current Bankruptcy Code, it deliberately reduced the role of judges in making valuation determinations in order to induce greater market participation.[213] There are alternatives to market-derived valuations, such as expert testimony, which can inform how much a judge thinks junior stakeholders should pay. Yet, there is a strongly held view that market exposure tends to be a superior institutional choice because it promises broader participation.[214] As conceived by *LaSalle*, the new value corollary would also tend to induce bargaining amongst the parties: if shareholders did not like the prospect of market competition, they would have to pony up enough to obtain creditors' consent, through an affirmative plan vote.[215]

211. 526 U.S. 434 (1999).

212. *Id.* at 454 (the plan in *LaSalle* was "doomed . . . by its provision for vesting equity in the reorganized business in the Debtor's partners without extending an opportunity to anyone else either to compete for that equity or to propose a competing reorganization plan").

213. *Id.* at 457 ("[O]ne of the Code's innovations [was] to narrow the occasions for courts to make valuation judgments, as shown by its preference for the supramajoritarian [sic] class creditor voting scheme in § 1126(c) . . . ." (citation omitted)).

214. RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 221 n.4 (4th ed. 1992) ("It is the superiority of the market to the courts in determining subjective values that provides the major reason for the law's seeking to channel resource allocation through the market wherever possible.").

215. *LaSalle*, 526 U.S. at 458 n.28 ("Congress adopted the view that creditors and equity security holders are very often better judges of the debtor's economic viability and their own economic self-interest than courts, trustees, or the SEC . . . . Consistent with this new approach, the Chapter 11 process relies on creditors and equity holders to engage in negotiations toward resolution of their interests." (quoting G. Eric Brunstad, Jr., Mike Sigal & William H. Schorling, *Review of the Proposals of the National Bankruptcy Review Commission Pertaining to Business Bankruptcies: Part One*, 53 BUS. LAW. 1381, 1406 n.136 (1998))).

All of these forms of participation—through the vote, the market, and the negotiated deal—were threatened by the structured dismissal in *Jevic*, because there would be no need or place for plans in a world where priority-skipping dismissals were permissible over objection.

3. Participation Through Committees

Bargaining is relatively easy in small groups. It becomes more difficult as the number of participants grows. As noted, large and medium-sized Chapter 11 cases can involve hundreds or thousands of stakeholders. This impedes direct bargaining, and instead requires representative participation, through "committees."

Section 1102 of the Bankruptcy Code provides that "the United States trustee shall appoint a committee of creditors holding unsecured claims . . . . ordinarily consist[ing] of the persons, willing to serve, that hold the seven largest claims against the debtor of the kinds represented on such committee . . . ."[216] "The concept of a creditors' committee has great appeal," Harner and Marincic observe.[217] "It signifies representation and cooperation—key elements of most successful debt restructuring plans" because it "presents a potential solution to the collective action problem that often impairs debt restructuring efforts."[218]

But committees are imperfect representatives. They have no statutory mandate to bind unsecured creditors for most purposes.[219] While they have standing to object to important matters in a case,[220] there is no guarantee that they speak for all or even many creditors. In theory, the committee is supposed to represent creditors holding "representative"

---

216. 11 U.S.C. § 1102(a)–(b) (2012).

217. Michelle M. Harner & Jamie Marincic, *Committee Capture? An Empirical Analysis of the Role of Creditors' Committees in Business Reorganizations*, 64 VAND. L. REV. 749, 756 (2011).

218. *Id.* Courts have the discretion to appoint additional committees of junior stakeholders, such as shareholders or creditors holding special types of claims (e.g., tort claims if the debtor is a mass tortfeasor). 11 U.S.C. § 1102(a)(2); *In re* Spansion, Inc., 421 B.R. 151, 156 (Bankr. D. Del. 2009); *In re* Dana Corp., 344 B.R. 35, 38 (Bankr. S.D.N.Y. 2006).

219. Bussel & Klee, *supra* note 15, at 688 ("[T]he phenomenon of official creditors' committees serving as proxies for unsecured creditors has developed entirely outside the statute itself and reinforces the power of self-pronounced 'major parties.' The statutory powers and duties of committees nowhere suggest that committee consent may bind its constituency; their statutory role is to investigate on behalf of, and to inform and advise constituents, not consent for them." (citations omitted)).

220. For example, the committee in *Jevic* could have objected to the structured dismissal there. Statutory committees have standing to support or oppose Rule 9019 settlement motions. 11 U.S.C. § 1109(b); FED. R. BANKR. P. 2018.

claims, which is a bit of a tautology.[221] In *Jevic*, the petitioning truck drivers held both priority wage claims and general unsecured claims.[222] From a distributive perspective, committee members holding priority claims may have different incentives and risk-preferences than those who don't. Moreover, in many small and medium-sized cases, committees may not be appointed at all.[223]

As noted above,[224] the ALI Principles indicate that representative consent may be acceptable where the representatives satisfy certain ethical criteria. While it is not clear whether, or to what extent, Chapter 11 practice may include those or similar mechanisms, *Jevic* will likely heighten sensitivity to conflicts and underrepresentation that can impair participation in the reorganization process. *Jevic* can thus be seen as an invitation—or warning—to those who would participate on or represent (as counsel) creditors' committees to take more seriously their obligation to ascertain and advocate the interests of all they purport to represent, or to find ethical ways to address underlying conflicts. Chapter 11's committee structure was designed to promote this sort of participation, even as developments in Chapter 11 practice may have made it more challenging.

4. The Price and Promise of Participation—Final Distributions

Although *Jevic* affirms the role of stakeholder participation in Chapter 11 cases, there should be no illusions about its costs: participation in reorganization is a double-edged sword. It might sound good to say that stakeholders should participate in reorganization, through plans or consent. Yet, the response may be that there is already too much participation, and that the structured dismissal arose as a way to contain participation's excessive costs. Some sophisticated creditors—especially distress investors fighting over the valuation of the debtor with senior creditors—participate actively. Many worry that this

---

221. 11 U.S.C. § 1102(b)(1). The statute merely requires that it "shall ordinarily consist of the persons, willing to serve, that hold the seven largest claims against the debtor of the kinds represented on such committee." *Id.*

222. Czyzewski v. Jevic Holding Corp., 580 U.S. __, 137 S. Ct. 973, 981 (2017).

223. Because creditors may be unwilling to serve, in most Chapter 11 cases no committee is appointed. 7 COLLIER ON BANKRUPTCY ¶ 1102.02[1][a] (Richard Levin & Henry J. Sommer eds., 16th ed. 2018); *see also* Lynn M. LoPucki, *The Debtor in Full Control—Systems Failure Under Chapter 11 of the Bankruptcy Code?*, 57 AM. BANKR. L.J. 99 (1983); Lynn M. LoPucki, *The Debtor in Full Control—Systems Failure Under Chapter 11 of the Bankruptcy Code?*, 57 AM. BANKR. L.J. 247, 250 (1983).

224. *See supra* section II.A.3.

participation can be a costly sideshow of little benefit to reorganizing debtors or their larger constituencies.[225]

This, then, raises the question: why does participation matter in bankruptcy? Resolving corporate financial distress need not be participatory, and is not always so. For example, the bank failure regime in the United States is decidedly non-participatory.[226] When banks fail, they cannot use the Chapter 11 system.[227] Instead, they are seized without warning by their regulators and are liquidated or sold in short order.[228] Creditors of the bank—in particular, individual depositors—do not participate in the process because participation in that context would likely be disastrous: bank runs, not workout negotiations, would ensue.[229] But these sorts of panics are generally limited to banks, whose depositors—an important class of creditors—have little ability to coordinate amongst themselves or to negotiate with the bank.

Chapter 11 is different because the expectation is that corporate stakeholders can or should be able to fend for themselves more effectively than retail bank depositors.[230] This expectation reflects what may be a fairly efficient division of labor. The logic is that those in control of the debtor (presumptively managers, but also senior creditors, to an important extent) would have greater insight into how to maximize the value of assets than would stakeholders at large. Corporate debtors will often be managed in reorganization by "turnaround managers," who have (or should have) expertise in value-maximization. While there are concerns about the influence that these managers can wield, there is little

---

225. *Compare* Jonathan C. Lipson, *The Shadow Bankruptcy System*, 89 B.U. L. REV. 1609 (2009), *with* Jared A. Ellias, *The Shadowy Contours of Bankruptcy Resistant Investments*, 114 COLUM. L. REV. SIDEBAR 123 (2014), https://ssrn.com/abstract=2638901 [https://perma.cc/LYL3-MZZM]. *See also Heins v. Ruti-Sweetwarter, Inc.* (*In re* Ruti-Sweetwater, Inc.), 836 F.2d 1263, 1266 (10th Cir. 1988) (expressing concern about situations where "a creditor may sit idly by, not participate in any manner in the formulation and adoption of a [Chapter 11 plan] and thereafter, subsequent to the adoption of the plan, raise a challenge to the plan for the first time").

226. Jonathan C. Lipson, *Against Regulatory Displacement: An Institutional Analysis of Financial Crises*, 17 U. PA. J. BUS. L. 673 (2015).

227. 11 U.S.C. § 109 (2012) (defining who may be a debtor so as to exclude banks).

228. *See, e.g.*, Lipson, *supra* note 226, at 709 ("Under federal banking law, the Federal Deposit Insurance Corporation (FDIC) or other designated regulator may seize a bank that is 'critically undercapitalized,' a minimum of two percent equity capital to total assets.").

229. *Id.* at 711 (discussing participatory problems with bank failure regime, and observing that "[w]hile courts certainly could supervise bank failures—and do so in many nations—there are sound institutional reasons for leaving that choice with government").

230. There are, of course, other institutional reasons for the difference in treatment as well, including that banks are thought to perform a special function in the economy. *Id.*

doubt that they would know more about how to make the most of a debtor's assets than would general unsecured creditors.

The same cannot be said for final distributions. Insiders will not have greater expertise about how the consideration received in the sale should be distributed to the debtor's full body of stakeholders. Indeed, self-interest would make it hard for those insiders to maximize distributions to others, even as it may spur them to maximize asset value. Participation by all stakeholders in that latter decision—through a plan or consent to a structured dismissal or absolute priority—would seem to be the best way to prevent the expropriation likely to occur when a small group of insiders gets to decide what a large group of outsiders receives. The structured dismissal approved by the lower courts in *Jevic* would have impaired this division of participatory labor by vesting in insiders the power to control both pre-plan sales (asset-value maximization) *and* final distributions. It would have neutralized the last vestige of creditor participation in the reorganization process over the things that, functionally, matter the most to them: how they actually get paid (if at all).

B. Predictability and Procedural Integrity

While participation may be the most complex and important process value that *Jevic* advances, the majority opinion was also motivated by concerns about predictability and procedural integrity. To take these concerns seriously is to see that they also advance goals of responsible participation needed to induce consent.

1. Predictability

Predictability is at once an obvious process value in our legal system and yet especially challenging in the "unruly"[231] world of corporate reorganization. It is a core goal of our legal system—the premise and perhaps the product of stare decisis in common law adjudication.[232] As

231. *See* RadLAX Gateway Hotel, LLC v. Amalgamated Bank, 566 U.S. 639, 649 (2012) (noting the importance of clarity and predictability in light of the fact that the "Bankruptcy Code standardizes an expansive (and sometimes unruly) area of law").

232. Stare decisis derives from the maxim stare decisis et non quieta movere, which means "to abide by the precedents and not to disturb settled points." 18 JAMES WM. MOORE ET AL., MOORE'S FEDERAL PRACTICE § 134.01[1] (3d ed. 2017). Stare decisis is settled precedent that "reaches its apogee when a single precedent is considered to be a 'binding' authority." Marla Brooke Tusk, *No-Citation Rules as a Prior Restraint on Attorney Speech*, 103 COLUM. L. REV. 1202, 1206 (2003) (quoting Frederick G. Kempin, Jr., *Precedent and Stare Decisis: The Critical Years, 1800 to 1850*, 3 AM. J. LEGAL HIST. 28, 29 (1959)).

Michael Van Alstine recently observed, "[v]ertical stare decisis . . . serves the core values of system stability and predictability, for it is by this means that the precedents of superior courts have practical effect through mandatory adherence by inferior courts throughout the system."[233] Like other courts, bankruptcy courts express a strong appreciation for the virtues of stare decisis[234] and the predictability that that principle provides.[235]

The majority opinion in *Jevic* promoted predictability in two ways. First, being a static structure, the absolute priority rule likely reduces resolution costs in large and medium-sized bankruptcy cases. For many observers, the rigidity of the APR promotes ex ante investment because creditors know, beforehand, where they will stand in relation to one another (and the debtor's shareholders) if the debtor fails.[236] This is plausible. But, it also has ex post efficiency benefits, precisely because it is a simpler framework in which to bargain to the endgame after default.[237] This has a strong intuitive appeal, because a more narrowly tailored range of potential outcomes should usually make it easier to bargain.

Good lawyers—especially those who work in an environment like Chapter 11, where bargaining is a key form of participation—understand that expectations about final period play influence that which comes

233. Michael P. Van Alstine, *Stare Decisis and Foreign Affairs*, 61 DUKE L.J. 941, 963 (2012).

234. *See, e.g.*, *In re* Gen. Motors Corp., 407 B.R. 463, 504 (Bankr. S.D.N.Y. 2009). Judge Gerber said the following:

> This Court follows the decisions of its fellow bankruptcy judges in this district, in the absence of plain error, because the interests of predictability in commercial bankruptcy cases are of such great importance. Apart from the underlying reasons that have caused stare decisis to be embedded in American decisional law, stare decisis is particularly important in commercial bankruptcy cases because of the expense and trauma of any commercial bankruptcy, and the need to deal with foreseeable events, by pre-bankruptcy planning, to the extent they can be addressed.

Id.

235. *See, e.g.*, *In re* Adelphia Commc'ns Corp., 359 B.R. 65, 72 n.13 (Bankr. S.D.N.Y. 2007) ("This Court has been on record for many years as having held that the interests of predictability in this District are of great importance . . . .").

236. Roe & Tung, *supra* note 12, at 1236 ("The absolute priority rule provides the fixed framework within which the players negotiate the plan of reorganization and within which the judge evaluates it."); *see also* Adler, *supra* note 12, at 214 ("Anticipation of breaches in absolute priority can raise a firm's ex ante cost of capital.").

237. Roe & Tung, *supra* note 12, at 1279 (observing that in some cases under the APR, "the resulting transactional, doctrinal, and legislative structures are more efficient and fair than what they replace"); *see also* Kenneth M. Ayotte & Edward R. Morrison, *Creditor Control and Conflict in Chapter 11*, 1 J. LEGAL ANALYSIS 511, 513 (2009) (noting intercreditor conflict is common and "distorts outcomes in bankruptcy cases").

before.[238] It is, for example, well understood that the "shadow" cast by different resolution standards affects the bargaining over whether to settle or try a case.[239] At least as a general proposition, the greater the uncertainty, the greater the likelihood of protracted litigation.[240]

So, too, in corporate reorganization. While adjudication of a "non-consensual" plan is not a trial in a traditional sense,[241] the shadow cast by the rules that govern final distributions absent consent to an alternative will necessarily affect the participation that occurs before the final distributions are made. If parties understand that the endgame will be either consent or absolute priority, they will bargain in one way. If, instead, they know that the endgame permits priority (and perhaps other) deviations via structured dismissals that are unpredictable ex ante, they will bargain differently. Although reasonable minds might differ about this, it would appear that uncertainty increases the risks of strategic litigation and expropriation. Because absolute priority is axiomatically more certain than relative priority, it would appear to be a less costly default rule.

Second, the *Jevic* majority appears to have been skeptical that the deviation approved by the courts below could be limited to "rare" cases

238. *In re* Alpha Nat. Res., Inc., 546 B.R. 348, 358 (Bankr. E.D. Va.) ("The [management retention plan] ensures that the Debtors maintain a keen focus on the Chapter 11 end-game, by making a significant part of the bonus pool contingent on confirmation of a plan of reorganization."), *aff'd sub nom*. United Mine Workers of Am. 1974 Pension Plan & Tr. v. Alpha Nat. Res., Inc., 553 B.R. 556 (E.D. Va. 2016); Ingrid C. Palermo, *The Changing Face of Bankruptcy Law*, 2014 WL 788389, at *4 ("If you file for Chapter 11 but do not have an end-game strategy, you are doomed to fail.").

239. *See, e.g.*, Robert Cooter et al., *Bargaining in the Shadow of the Law: A Testable Model of Strategic Behavior*, 11 J. LEGAL STUD. 225 (1982); Samuel R. Gross & Kent D. Syverud, *Getting to No: A Study of Settlement Negotiations and the Selection of Cases for Trial*, 90 MICH. L. REV. 319, 320 (1991); Robert H. Mnookin & Lewis Kornhauser, *Bargaining in the Shadow of the Law: The Case of Divorce*, 88 YALE L.J. 950 (1979); George L. Priest & Benjamin Klein, *The Selection of Disputes for Litigation*, 13 J. LEGAL STUD. 1 (1984); George L. Priest, *Reexamining the Selection Hypothesis*, 14 J. LEGAL STUD. 215 (1985).

240. This is most commonly captured in the view that trials in traditional litigation represent predictive errors. Robert D. Cooter & Daniel L. Rubinfeld, *Economic Analysis of Legal Disputes and Their Resolution*, 27 J. ECON. LIT. 1067, 1074 (1989) (trials result from "mistaken prediction[s]" made by parties). *See generally* Priest & Klein, *supra* note 239, at 16 (suggesting that "more uncertainty as to . . . outcomes" produces "more disagreement between the parties"). *Cf.* Jason Scott Johnston, *Bargaining Under Rules Versus Standards*, 11 J.L. ECON. & ORG. 256, 275 (1995) (arguing that the uncertainty of incomplete entitlements can lead to efficient bargaining outcomes).

241. But there will be a "trial" in a functional sense. *See, e.g.*, *In re* Tex. Rangers Baseball Partners, No. 10-43400 (DML), 2010 WL 4106713, at *2 (Bankr. N.D. Tex. Oct. 12, 2010) (observing that plan is confirmed under Rule 52 of the Federal Rules of Civil Procedure, as made applicable by Bankruptcy Rules 7052 and 9014, governing "contested matters").

because *Jevic*, itself, was not a rare case. The Third Circuit majority had reasoned that priority-skipping final distributions may be approved "in a rare case,"[242] if the bankruptcy court has "specific and credible grounds to justify [the] deviation."[243] The Court rejected this, noting that it was "difficult to give precise content to the concept 'sufficient reasons'" to justify a priority deviation at the end of a case.[244] "That fact," the majority observed, "threatens to turn a 'rare case' exception into a more general rule."[245]

The Court rejected the claim that there could be no resolution without skipping the drivers' claims, or even that the distributions approved by the lower courts "would make some creditors (high- and low-priority creditors) better off without making other (mid-priority) creditors worse off (for they would receive nothing regardless)."[246] If there was, in fact, nothing rare about this case, the majority reasoned, "one can readily imagine other cases that turn on comparably dubious predictions. The result is uncertainty. And uncertainty will lead to similar claims being made in many, not just a few, cases."[247] Practice under Chapter 11 is replete with stories of ostensibly "rare" departures from a statutory standard becoming the norm.[248] Justice Breyer, writing for the majority, was right to worry about the slippery slope of *Jevic*'s structured dismissal.

Yet, predictability can be problematic in bankruptcy for a variety of reasons. The resource constraints that lead to bankruptcy do not vanish once a company commences a case, even as it may temporarily be

---

242. Official Comm. of Unsecured Creditors v. CIT Grp./Bus. Credit Inc. (*In re* Jevic Holding Corp.), 787 F.3d 173, 175 (3d Cir. 2015), *rev'd sub nom.* Czyzewski v. Jevic Holding Corp., 580 U.S. __, 137 S. Ct. 973 (2017).

243. *Id.* at 184 (quoting Motorola, Inc. v. Official Comm. of Unsecured Creditors (*In re* Iridium Operating LLC), 478 F.3d 452, 466 (2d Cir. 2007)) (alteration in original). Judge Scirica's dissent in the opinion below was also appropriately skeptical.

> It is not unusual for a debtor to enter bankruptcy with liens on all assets, nor is it unusual for a debtor to enter Chapter 11 proceedings . . . with the goal of liquidating . . . . It is also not difficult to imagine another secured creditor who wants to avoid providing funds to priority unsecured creditors . . . .

Id. at 189–90 (Scirica, J., dissenting).

244. *Jevic*, 137 S. Ct. at 986.

245. *Id.*

246. *Id.* (observing that "the record provides equivocal support" for the lower courts' predictions about resolution absent the structured dismissal approved below).

247. *Id.* ("[O]nce the floodgates are opened, debtors and favored creditors can be expected to make every case that 'rare case.'" (quoting Frederick F. Rudzik, *A Priority Is a Priority Is a Priority—Except When It Isn't*, AM. BANKR. INST. J., Sept. 2015, at 16, 79)).

248. As discussed in section IV.B, *infra*, "superpriority" debtor in possession financing was meant to be rare but is now commonplace.

protected from collection litigation. Congress made Chapter 11 flexible to give parties and judges leeway to craft and recognize creative, negotiated resolutions.[249] Flexibility entails discretion, which, in turn, permits (and perhaps promotes) uncertainty. While the Court has sought to cabin the discretion of bankruptcy judges,[250] Chapter 11 gives them significant powers over the corporate debtors that appear before them.

Observers worry that this discretion may contribute to capture of the bankruptcy bench by the bankruptcy bar. Lynn LoPucki, for example, has argued that the bankruptcy bench and bar in Delaware and New York have been corrupted by the desire to run big Chapter 11 cases in those venues.[251] Although the structured dismissal is not limited to use there, *Jevic* did come out of the Bankruptcy Court for the District of Delaware, which is the nation's busiest Chapter 11 court. That court appears to have been highly receptive to innovations like structured dismissals that may seem appropriate in a given case, but that can over time expand to tolerate normative outcomes that defy both the will of Congress and the participatory goals of Chapter 11.

2. Procedural Integrity

Concerns about the unruly nature of bankruptcy courts also inform the Court's views in *Jevic* about integrity in the Chapter 11 process, generally. Integrity has special resonance for bankruptcy practice, which has at times been caricatured as little more than a "ring" of parasites gnawing away at the carcass of the failed debtor.[252]

Today, notwithstanding provocative claims to the contrary, there is little direct evidence of that sort of collusion. Instead, dominant parties in Chapter 11 cases may enter into agreements, like the structured dismissal in *Jevic.* Such agreements have the potential to defy mandatory and well-justified rules, including those on absolute priority,

249. *See* Lipson, *supra* note 225, at 1654 (observing that designed Chapter 11 bankruptcy "to be highly flexible, to permit the reorganization of small, local firms as well as very large public companies").

250. *See* Law v. Siegel, 571 U.S. __, 134 S. Ct. 1188, 1196 (2014) ("The Code's meticulous—not to say mind-numbingly detailed—enumeration of exemptions and exceptions to those exemptions confirms that courts are not authorized to create additional exceptions.").

251. *See* LYNN M. LOPUCKI, COURTING FAILURE: HOW COMPETITION FOR BIG CASES IS CORRUPTING THE BANKRUPTCY COURTS (2005).

252. See H.R. REP. NO. 95-595, at 6011 (1977) (describing the "unseemly and continuing relationship" under pre-Code practice among bar and judges as a "bankruptcy ring"); Laura Napoli Coordes, *The Geography of Bankruptcy*, 68 VAND. L. REV. 381, 439 (2015).

designed to protect those who, for whatever reasons, do not participate in the deal.[253]

For the *Jevic* majority, sustaining the courts (and the deal) below risked promoting this sort of soft collusion in three ways. First, as the Court observed, approving this structured dismissal would invite junior and senior creditors to join forces in order to squeeze out those in the middle, as would have happened to the drivers in *Jevic*.[254] This was, in form, the problem in the equity receiverships that both led to the formulation of the APR and to Congress's basic approach to reorganization under Chapter 11. The guardrails of the plan process were designed, among other things, to prevent a recurrence of the abuses of the receiverships.

Second, the structured dismissal would have released CIT and Sun from liability in connection with the LBO.[255] This would have created even greater problems. Recall that they had been significantly responsible for the LBO, had presumably benefited from it, and were now seeking to use the structured dismissal to limit liability for the harm it allegedly caused. It would have been one thing had the drivers agreed to the settlement and release contained in the structured dismissal; then, Sun and CIT could legitimately say that the structured dismissal simply purchased peace for a price acceptable to all involved. But the drivers objected, and the bankruptcy court approved the release anyway. Even this may not have been problematic, if the drivers had been permitted to sue Sun and CIT in state court after the dismissal, given that state law apparently created a cause of action under New Jersey's fraudulent transfer law. Instead, the dismissal took the extraordinary step of effectively barring the drivers from suing Sun and CIT outside bankruptcy court.[256]

Although the *Jevic* majority did not focus on this, it is hard to overstate the danger the release created. Fraudulent transfer law may be one of the last checks on excessive lending in the acquisition context. It

253. *See* Bank of Am. Nat'l Tr. & Sav. Ass'n v. 203 N. LaSalle St. P'ship, 526 U.S. 434, 444 (1999) (discussing how the absolute priority rule was developed in response to "concern with 'the ability of a few insiders, whether representatives of management or major creditors, to use the reorganization process to gain an unfair advantage'" (quoting H.R. DOC. NO. 93-137, pt. 1, at 255 (1973))).

254. Structured dismissals like those in *Jevic* present "risks of collusion, *i.e.*, senior secured creditors and general unsecured creditors teaming up to squeeze out priority unsecured creditors." Czyzewski v. Jevic Holding Corp., 580 U.S. __, 137 S. Ct. 973, 987 (2017) (citing *LaSalle*, 526 U.S. at 444).

255. *See* discussion *supra* note 46.

256. *See* discussion *supra* note 46.

says to investors such as Sun and lenders such as CIT that if an acquisition is too leveraged, and that leverage harms the debtor and its other creditors, they—the parties that struck and benefited from the deal—will be liable to the creditors harmed by it. If, instead, the Suns and CITs of the world know that they can use a structured dismissal to escape liability for deals that harm other stakeholders, they will have less reason to exercise restraint in those deals. It would invite collusion ex ante between the leveraged acquirers and sellers of businesses, who would know that they could easily disable an important deterrent to such deals through a structured dismissal.

Third, *Jevic* recognizes that integrity requires respect for cost, and in particular the cost of bargaining to a consensual resolution.[257] As noted above, the uncertainty introduced by deviations from the absolute priority rule, and the "rare case" exception crafted by the lower courts, would have invited more litigation to clarify—or exploit—this uncertainty. This would have driven up the cost of resolving Chapter 11 cases after *Jevic*. While some distress professionals may benefit from such a state of affairs, those for whom the system exists would not.

C. Jevic*'s Assumption—Equity in the Estate*

Jevic's procedural logic turns on a crucial assumption: that there is equity in the estate sufficient to fund a case and produce some return to stakeholders other than senior secured creditors; that is, that there are stakeholders who are "in the money." Here, the drivers were in the money because the proceeds of the fraudulent transfer suit were property of the estate, and they were next in line to receive them, but for the structured dismissal.

But this will not always be the case. Practitioners view the structured dismissal as especially appropriate where the debtor's assets have been sold, leaving it with "no unsecured assets to administer or with insufficient unsecured assets to fund a confirmable plan."[258] It would not be difficult to apply absolute priority where a debtor has fully encumbered its assets: the senior secured creditor would take everything. That, then, begs a question: why bother with Chapter 11 reorganization and *Jevic*'s process values at all? What work does *Jevic* really do if, as

257. *Jevic*, 137 S. Ct. at 987 ("And they include making settlement more difficult to achieve." (citing William M. Landes & Richard A. Posner, *Legal Precedent: A Theoretical and Empirical Analysis*, 19 J.L. & ECON. 249, 271 (1976))).

258. Pernick & Dean, *supra* note 29, at 1, 58–59; *see also In re* Petersburg Regency LLC, 540 B.R. 508, 531 (Bankr. D.N.J. 2015) (approving structured dismissal over equity holders' objection on grounds that there was no equity in assets).

explained in the next part, debtors fully encumber their assets prior to bankruptcy, such that it may be impossible to pay mid-priority or junior claimants under "ordinary" priority?

IV. THE SECRET LIFE OF PRIORITY: PRIORITY AS PROCESS

The answer, perhaps counterintuitive, is that *Jevic*'s process values—participation, predictability, and procedural integrity—provide a basis for resisting the power that senior secured creditors seem often to exercise in reorganization.

Priority lives a dual life. It is a substantive doctrine about the distribution of property, but it also has strong procedural effects.[259] Because senior creditors frequently do not actually want immediate liquidation shares of the property in which they have priority (because the value would be depressed), they have instead learned to use their leverage to obtain procedural power over the reorganization of distressed companies—that is, to fight for future value. *Jevic*'s logic demands an assessment of the procedural power that senior creditors have accrued and boundaries to manage that power.

A. Priority as Process

To some extent, senior creditors have long enjoyed procedural advantages over junior stakeholders. Article 9 of the Uniform Commercial Code, for example, permits secured creditors to use self-help to take personal property securing their loan, provided that they can do so without "breach of the peace."[260] Mortgagees use judicial processes to realize on their priority interest in real property over other competing claimants, such as unsecured creditors who may seek to establish judgment liens on the property.

---

259. Jay Westbrook was among the first to identify the distinct relationship between priority and process. *See* Westbrook, *supra* note 16, at 797 (arguing that "control of the bankruptcy process, rather than formal rules of security and priority, is the key to understanding both secured-credit and bankruptcy law: Control is the function of bankruptcy; priority is the end for which it is employed"). I recognize that this assumes a somewhat artificial distinction between "substantive" and "procedural" rules. Whether this distinction exists in the abstract is a question of jurisprudence beyond the scope of this paper.

260. U.C.C. § 9-609 (AM. LAW INST. & UNIF. LAW COMM'N 2010). Of course, situations involving multiple layers of secured creditors present much more interesting and challenging situations than may concern us here. *See, e.g.*, Frierson v. United Farm Agency, 868 F.2d 302, 305 (8th Cir. 1989) (junior creditor who garnishes collateral takes subject to senior creditor's security interest).

Indeed, senior creditors had so much power outside bankruptcy that Chapter 11 was conceived in important part as a way to level the playing field as among senior creditors, a debtor, and its junior stakeholders.[261] "The Chapter 11 process," legislative history observed, "involves a system of checks and balances designed to protect and promote the interests of all the affected parties."[262]

In the past twenty-five years, however, senior secured credit has exploded as a financing tool,[263] and senior creditors have learned how to use the power of their priority to usurp control of the process. Many observers worry that the growing power of senior creditors is the single greatest challenge to the efficiency and integrity of Chapter 11.[264] An

261. As legislative history explains:

> [R]eorganization, in its fundamental aspects, involves the thankless task of determining who should share the losses incurred by an unsuccessful business and how the values of the estate should be apportioned among creditors and stockholders. In a large public company, whose interests are diverse and complex, the most vulnerable today are public investors who own subordinated debt or equity securities. The bill, like Chapter X, is designed to counteract the natural tendency of a debtor in distress to pacify large creditors, with whom the debtor would expect to do business, at the expense of small and scattered public investors.

S. REP. NO. 95-989, at 10 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5787, 5796; *see also* Jay Lawrence Westbrook, *Secured Creditor Control and Bankruptcy Sales: An Empirical View*, 2015 U. ILL. L. REV. 831, 833 ("Traditionally, the various institutions of modern Chapter 11 bankruptcy produced a certain balance among the debtor and various creditor constituencies.").

262. *A Bill to Amend Title 11, United States Code, The Bankruptcy Code, Regarding Benefits of Certain Retired Employees: Hearing on S. 548 Before the Subcomm. on* Courts and Admin. Practice of the S. Comm. on the Judiciary, 100th Cong. 154 (1987) (statement of Richard A. Gitlin, President, American Bankruptcy Institute).

263. As long ago as 1994, Robert Scott observed:

> [A]sset-based [i.e., secured] financing has undergone an enormous transformation since the enactment of Article 9. The most vivid illustration of this is the dramatic increase in the number and size of firms that rely on secured credit as their principal means of financing both ongoing operations and growth opportunities. Previously, with a few exceptions (such as factoring and trust receipts), secured financing principally had served second-class markets as the "poor man's" means of obtaining credit. Now, it has become the linchpin of private financing, prompting even large firms to employ leveraged buyouts as a means of fleeing public equity markets for the safe harbors of Article 9. When viewed in these terms, Article 9 can only be seen as a blazing success.

Robert E. Scott, *The Politics of Article 9*, 80 VA. L. REV. 1783, 1784–85 (1994). The rise of secured credit was significantly facilitated by the enactment of Article 9 of the Uniform Commercial Code, which was, in turn, importantly shaped by both scholars, such as Grant Gilmore, and scholar-practitioners, such as Homer Kripke, who for much of his career was, coincidentally, with CIT. Grant Gilmore, *Dedication to Professor Homer Kripke*, 56 N.Y.U. L. REV. 9, 11 (1981). Kripke, like most advocates of that law, viewed it as means to advance distributive—not procedural—goals. "[T]he legal structure of secured credit developed to make possible mass production and the distribution of goods" which, he argued, "have increased human welfare." Homer Kripke, *Law and Economics: Measuring the Economic Efficiency of Commercial Law in a Vacuum of Fact*, 133 U. PA. L. REV. 929, 931 n.14 (1985).

264. Westbrook, *supra* note 261, at 833 ("Secured creditors have by far the most effective tools for upsetting that balance and obtaining control of Chapter 11 cases, converting the Debtor in Possession ('DIP') to a Secured Party in Possession."); *see also* Douglas G. Baird & Robert K.

extensive report by the American Bankruptcy Institute recently warned that senior creditors use their priority rights to "increase their control over borrower cash and ultimately over a Chapter 11 filing."[265] Professor Tabb puts the point bluntly: "the entire reorganization is dependent on the good graces of the pre-bankruptcy controlling secured lender."[266]

Although *Jevic* involved priority, it was not directly about the power of senior creditors. Rather, it was about the status of mid-priority creditors, squeezed by the senior creditors and junior shareholders. But, as explained below, Jevic's senior creditor, CIT, got to control the process from the beginning through terms approved by the bankruptcy court in a "super-priority" case-financing agreement. Senior creditors such as CIT use these agreements to control or strongly influence most of the succeeding decisions in the case, including whether, when, and how to sell assets.

Structured dismissals may be especially attractive to senior creditors because they would provide control at the final stage—distributions. In other words, even before *Jevic*, senior creditors have often been able to control the beginning and middle of cases. But they could not control the end. The structured dismissal approved by the lower courts would have

---

Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV. 751, 754–55 (2002) (describing a fundamental shift in Chapter 11 bankruptcy from a reorganization vehicle to a means of liquidation driven in large part by secured creditors who increasingly view the sales value of a firm's current assets as greater than the going-concern value of those assets in the future); Brubaker & Tabb, *supra* note 16, at 104–05 (writing that fundamental changes in the financial world, including the growing power of secured creditors, have brought an end to traditional Chapter 11 reorganizations); Harvey R. Miller & Shai Y. Waisman, *Is Chapter 11 Bankrupt?*, 47 B.C. L. REV. 129, 131 (2005) (writing that creditors increasingly use bankruptcy to effectuate favorable asset sales with no attempt at reorganization); David A. Skeel, Jr., *Creditors' Ball: The "New" New Corporate Governance in Chapter 11*, 152 U. PA. L. REV. 917, 919–20 (2003) (discussing a shift to increasing secured creditor control in Chapter 11 bankruptcy as a result of the debtor in possession financing provisions in section 364, which skew any incentive the DIP lender otherwise had in the creditor's reorganization); Elizabeth Warren & Jay L. Westbrook, *Secured Party in Possession*, AM. BANKR. INST. J., Sept. 2003, at 12 (expressing concern about secured creditor control of the Chapter 11 process); Westbrook, *supra* note 16, at 843–44 (describing the rise within Chapter 11 bankruptcy of the secured-party-in-possession: secured parties which are able to assert their Article 9 rights to payment, security, and control within the bankruptcy proceeding).

265. ABI REPORT, *supra* note 7, at 215 n.784 (quoting *ASM Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11*, at 1–2 (Apr. 19, 2013) (statement of John Haggerty)).

266. Tabb, *supra* note 30, at 768. The idea that senior creditors can assert control rights is not, itself, new. George Triantis was the first to discuss control rights and the way in which they inhere in debt instruments. *See* George G. Triantis, *Debt Financing, Corporate Decision Making, and Security Design*, 26 CANADIAN BUS. L.J. 93, 100–02 (1996); George G. Triantis, *The Interplay Between Liquidation and Reorganization in Bankruptcy: The Role of Screens, Gatekeepers, and Guillotines*, 16 INT'L REV. L. & ECON. 101, 104–08 (1996). What is new, as explained below, is the extent to which senior creditors can use priority to capture control of the process, itself.

changed that. Vesting this much power in any single stakeholder in a Chapter 11 case would have magnified risks of expropriation and error.

B. Case Financing—"Super Priority" DIP Lending

Because the goal of Chapter 11 is the reorganization of troubled but viable going concerns, Congress recognized that operating debtors would need to use revenues from sales after commencement of the case. This might be a problem if a secured creditor's lien extended to revenues earned after commencement of the case. However, the Bankruptcy Code makes clear that property acquired by a debtor post-petition is generally free from prepetition security interests.[267] Post-petition earnings could, in theory, finance the case itself as well as the restructuring of the business and, ultimately, the Chapter 11 reorganization plan that would embody the "new deal" among the debtor and its stakeholders.

In many Chapter 11 cases, however, a debtor's revenues are inadequate to fund operations. The debtor will need post-petition debtor-in-possession (DIP) financing to remain in business throughout the bankruptcy.[268] Section 364 of the Bankruptcy Code governs these transactions. If a debtor cannot obtain post-petition financing on an unsecured or administrative priority basis, "section 364(c) . . . permits a debtor to provide . . . a claim with a . . . superpriority."[269] This super-priority places the holder ahead of all other priority claims.[270]

Super-priority lending requires a showing of serious need by the debtor and procedural protections for junior claimants.[271] It was meant to

---

267. For example, Bankruptcy Code section 552 limits the effectiveness of a secured creditor's security interest in property a debtor acquires after it commences its case to "proceeds, products" and so on of prepetition collateral. 11 U.S.C. § 552(b) (2012). In theory, property the DIP acquires post-petition that is not, itself, proceeds of prepetition collateral is available for the estate's use, unencumbered. Congress observed that this approach was "designed, among other things, to prevent windfalls for secured creditors and to give the courts broad discretion to balance the protection of secured creditors, on the one hand, against the strong public policies favoring continuation of jobs, preservation of going concern values and rehabilitation of distressed debtors, generally." 140 CONG. REC. H10, 768 (daily ed. Oct. 4, 1994); *see also* United Va. Bank v. Slab Fork Coal Co. (*In re* Slab Fork Coal Co.), 784 F.2d 1188, 1191 (4th Cir. 1986).

268. Nicole Stephansen, *Roll-Up Financing Gains Prominence*, RESTRUCTURING REV., June 2010, at 10, http://documents.lexology.com/2f2d4fb8-6839-49fd-a592-c8710bfab9a3.pdf [https://perma.cc/LY32-CMA5].

269. *Id.*; *see also* 11 U.S.C. § 364(c).

270. *See* Stephansen, *supra* note 268, at 10.

271. *In re* Levitt & Sons, LLC, 384 B.R. 630, 640–41 (Bankr. S.D. Fla. 2008) ("In the event the debtor is unable to obtain credit under the provisions of § 364(c) of the Bankruptcy Code, the debtor may obtain credit secured by a senior or equal lien on property of the estate that is already subject to a lien, commonly called a 'priming lien.'"). "Such relief may be granted so long as (1) the debtor is

be the exception rather than the rule, a last-resort financing. That, however, is not how Chapter 11 practice has developed. Super-priority DIP financing is now common, even in cases that are clearly not intended to be reorganizations, but instead merely controlled liquidations, such as *Jevic*.

Complicating matters is the fact that in some cases, the prebankruptcy senior lender will provide the post-petition DIP financing, and will ask that its prepetition claim be "rolled up" into the DIP loan.[272] This has the practical effect of "converting the DIP lender's (likely) undersecured pre-bankruptcy loan into a fully secured postpetition claim."[273] Moreover, property that the debtor might acquire post-petition would "cross-collateralize" the prepetition loan, further enhancing the senior creditor's security, even though those assets were meant to be available to the estate unencumbered.

Courts historically worried about the leverage roll-ups would give prebankruptcy lenders.[274] Today, however, they appear to be commonplace.[275] The concern is that lenders like CIT in *Jevic* can bargain for a roll-up because they can make it difficult for the debtor to shop elsewhere for a loan. If, for example, the prebankruptcy lender learns that a troubled debtor is attempting to negotiate for DIP financing as part of its bankruptcy planning, the secured creditor may not cooperate with other potential lenders or declare a default, forcing the debtor to commence a Chapter 11 case before it is ready to do so. Because corporate debtors' assets are often fully encumbered, their lender's prebankruptcy priority will give them leverage to become the only lender—and thus the lender under a priority-enhancing DIP loan.

This may seem counterintuitive, for two reasons: (1) why would the prebankruptcy lender want to lend more to a troubled company? and (2)

---

unable to obtain financing in any other permissible manner and (2) there is adequate protection of the interests of the holder of the lien on the property on which the senior lien is proposed to be granted." *Id.* (citing 11 U.S.C. § 364(d)(1)).

272. Lipson, *supra* note 114, at 252 (discussing development of roll-ups).

273. Roe & Tung, *supra* note 12, at 1251.

274. Otte v. Mfrs. Hanover Commercial Corp. (*In re* Texlon Corp.), 596 F.2d 1092, 1098 (2d Cir. 1979) (disapproving cross-collateralization in that case but declining to forbid it per se); *see also* Charles J. Tabb, *A Critical Reappraisal of Cross-Collateralization in Bankruptcy*, 60 S. CAL. L. REV. 109, 115 (1986).

275. *See* Marcia L. Goldstein, *Debtor in Possession Financing: Recommendations and Rebalancing*, *in* AM. BANKR. INST., DIP FINANCING, PRE-CONFIRMATION SALES AND OUT-OF-COURT RESTRUCTURINGS (2015) ("A debtor's prepetition secured lenders are often the only party willing to provide DIP financing. In fact, postpetition lenders have been the debtor's prepetition secured lenders in many of the major Chapter 11 cases filed over recent years."); Lipson, *supra* note 114, at 252–56 (discussing roll-up in *Colt* bankruptcy).

why would those who manage that company want to borrow on onerous terms? The answer to the first is that Chapter 11 adds value that other resolutions do not by providing a single forum and the preemptive power of federal bankruptcy law to resolve the debtor's distress.[276] Controlling the process assures the senior creditor of this value. The answer to the second is more complex and likely reflects the fact that in many cases, including *Jevic*, "turnaround" managers will have been appointed to oversee the reorganization. For whom these managers actually act is not entirely clear, but a cause for some concern. They may not act as fiduciaries for the debtor's residual claimants, in particular unsecured creditors, as doctrine requires.[277] Instead, relational theory predicts that they may have greater loyalty to those whose relationships matter to them, such as those with who control the debtor's purse.[278]

The DIP loan in *Jevic* is a textbook example of the latter concern. When the Jevic debtors filed their Chapter 11 petition on May 20, 2008 (the "petition date"), they asked the Bankruptcy Court to approve an "emergency" $60 million loan from their prebankruptcy lender, CIT, on a super-priority basis.[279] Although the stated "emergency" was the need to pay drivers to complete their routes,[280] the bulk of the loan was apparently used by CIT to repay itself.[281] Under the DIP loan, CIT

---

276. *See generally* Melissa B. Jacoby & Edward J. Janger, *Ice Cube Bonds: Allocating the Price of Process in Chapter 11 Bankruptcy*, 123 YALE L.J. 862, 870 (2014) (discussing the value added by Chapter 11 reorganization).

277. Jonathan C. Lipson, *Directors' Duties to Creditors: Power Imbalance and the Financially Distressed Corporation*, 50 UCLA L. REV. 1189, 1190 (2003) ("It has become commonplace—perhaps trite—to observe that once a corporation is in financial distress, duties of care and loyalty that ordinarily run solely to or for the benefit of shareholders 'shift' to corporate creditors.").

278. Lipson, *supra* note 114, at 278 (discussing "turnaround managers" who may be appointed to run the corporate debtor in chapter 11 and their loyalties).

279. DIP Motion, *supra* note 32, ¶¶ 26–27. The debtors also sought when they commenced the case to appoint a "chief restructuring officer." *See* Order Granting Motion of Debtors Pursuant to 11 U.S.C. Section 363 for Entry of an Order Approving the Retention of Morris Anderson & Associates Ltd. & Designating Daniel Dooley as Chief Restructuring Officer *Nunc Pro Tunc* to the Petition Date, *In re* Jevic Holding Corp., No. 08-01106 (BLS) (Bankr. D. Del. June 20, 2008).

280. According to the final order approving the financing, there was "[a]n immediate and critical need . . . for the Debtors to . . . obtain secured financing in order to manage the wind-down of the Debtor's business, attempt to deliver all of the freight in their system, retrieve their assets and effectuate a prompt and orderly liquidation of their assets and proceed towards a confirmable plan." Final Order (I) Authorizing Debtors-in-Possession to Obtain Senior Debtor-in-Possession Financing; (II) Granting Liens, Security Interests, & Superpriority Status; (III) Authorizing Use of Cash Collateral; & (IV) Affording Adequate Protection to Prepetition Lenders ¶ 9, *In re* Jevic Holding Corp., No. 08-01106 (BLS) (Bankr. D. Del. June 20, 2008) [hereinafter Final DIP Order].

281. *Id.* ¶ 43. ("[T]o the extent that the debtors obtain full and final approval of the Senior DIP Financing at the Final Hearing and the conditions precedent under the Senior DIP Credit Agreement to the availability of the Senior DIP Financing are satisfied or waived, then, within two business

would have super-priority in the debtor's assets, whether acquired before or during bankruptcy. The DIP loan—a rollup used to pay the senior creditor in a controlled liquidation—challenges the values of participation, predictability, and procedural integrity that the Supreme Court vindicated in striking the structured dismissal of the case.

1. Participation and the Jevic *DIP Financing*

The DIP financing in *Jevic* constricted participation in a variety of problematic ways. The first involved the process—or lack of process—leading to the DIP loan, itself. In *Jevic*, the request for financing was made on an emergency basis on the day the debtor commenced its case. The Bankruptcy Court approved it on an interim basis at a hearing two days later, and gave its final approval one month after the case was commenced, June 20, 2008.[282] When the motion was initially made, there was no official committee of unsecured creditors to represent Jevic's estimated 5,000–10,000 unsecured creditors. That group was not appointed until June 4, 2008,[283] about two weeks after the interim financing was approved, and two weeks before the final financing order was entered on June 20, 2008. It appears from the docket that neither the creditors' committee nor the United States Trustee formally objected to the DIP financing.[284]

As a practical matter, therefore, other stakeholders of the debtors had little opportunity to scrutinize either the proposed DIP loan or the prepetition loan that was rolled-up into it. So, for example, there is no evidence that any party tested the debtor's efforts to shop for other loans

days after the entry of the Final Order, the Debtors shall repay the Prepetition Lenders the then remaining unpaid principal amount of the Prepetition Financing, any accrued but unpaid interest (at the non-default rate), and reasonable professional fees and disbursements . . . ."). Thus, the loan was used to pay CIT long before there was any judicial determination on its allowability. *Id.*; *see also id.* at Exhibit A (budget for application of DIP loan proceeds).

282. *See* Final DIP Order, *supra* note 280.

283. *See* Notice of Appointment of Committee of Unsecured Creditors, *In re* Jevic Holding Corp., No. 08-11006 (BLS) (Bankr. D. Del. June 4, 2008).

284. The docket reveals only one limited objection to the DIP Financing, from Central Freight, which alleged that about $350,000 in cash held by the debtors was "in trust" for Central Freight, and so could not be subject to CIT's lien. Limited Objection of Central Freight Lines, Inc. to Emergency Motion for Final Order (I) Authorizing Debtors-In-Possession to Enter into Senior Debtor-In-Possession Credit Agreement & Obtain Postpetition Financing Pursuant to Sections 363 & 364 of the Bankruptcy Code; (II) Granting Liens, Security Interests & Superpriority Claims; (III) Authorizing the Use of Cash Collateral; (IV) Affording Adequate Protection to Prepetition Lenders; & (V) Providing for the Payment of Secured Prepetition Indebtedness, *In re* Jevic Holding Corp., No. 08-11006 (BLS) (Bankr. D. Del. June 5, 2008).

or better terms.[285] While the debtor may have needed funding to complete deliveries in transit, it is not clear why CIT needed to be repaid in full at the outset of the case, as well. Nor, more importantly, would there have been a meaningful opportunity to scrutinize CIT's prebankruptcy loan or conduct. This matters because, as discussed below,[286] the debtors had to agree to waive claims they had against CIT.

Despite the limited ability to scrutinize the DIP loan or CIT's pre-bankruptcy conduct, the court approved it. In doing so, the court converted CIT's prepetition loan into a post-petition loan which, pursuant to Bankruptcy Code section 364(c)(2), (c)(3), and (d), constituted "valid, binding, enforceable, first priority, and perfected Liens."[287] The new CIT loan would have priority over any other liens on the debtor's assets,[288] and "super-priority" status over any first-priority administrative expenses.[289] To protect this priority, Jevic was prohibited from incurring any first-priority administrative expenses, which would ordinarily include all operating expenses during bankruptcy, as well as professional fees. The super-priority status would continue even if the debtor's Chapter 11 case were converted to a liquidation under Chapter 7.[290] Moreover, the loan could not be "crammed down" to the value of the collateral in the event the debtor sought to confirm a plan of reorganization that sought to do so.[291] This would limit the debtor's options under any plan, if the case got that far.

The DIP loan also constrained participation for the rest of the case in other ways. First, like most DIP lenders, the DIP loan gave CIT a "veto"

285. Interestingly, the affidavit submitted by David Gorman, Jevic's CEO, said nothing about efforts to obtain financing from any other lenders. He stated that CIT and the lenders in its group were "willing to provide the financing contemplated herein," and that he "believe[d] that [the prepetition lenders] ha[d] acted in good faith in consenting to and in agreeing to provide the postpetition financing contemplated by" the DIP Financing Motions. *See* Declaration of David H. Gorman in Support of Debtors' Chapter 11 Petitions & First Day Motions ¶ 61, *In re* Jevic Holding Corp., No. 08-11006 (BLS) (Bankr. D. Del. May 20, 2008).

286. *See* discussion in this section.

287. Final DIP Order, *supra* note 280, ¶ 24.

288. *Id.* ¶ 26 (CIT's DIP financing liens could not be "subordinated to or made *pari passu* with any other Lien under section 364(d) of the Bankruptcy Code or otherwise.").

289. *Id.* ¶ 29 ("priority . . . over all administrative expenses of the kind specified in section 503(b) or 507(b) of the Bankruptcy Code").

290. *Id.*

291. As noted above, "[p]lans that are confirmed under section 1129(b) are often referred to as cramdown plans because they have been 'crammed down the throats of objecting creditors.'" River Rd. Hotel Partners, LLC v. Amalgamated Bank, 651 F.3d 642, 647 (7th Cir. 2011) (internal citations omitted), *aff'd sub nom.* RadLAX Gateway Hotel, LLC v. Amalgamated Bank, 566 U.S. 639 (2012).

over any major actions in the case.[292] For example, the loan agreement limited the debtors' ability to make non-ordinary course payments,[293] incur any indebtedness equal or senior in priority to the DIP financing,[294] or to make any disbursements materially outside the budget incorporated into the DIP financing.[295] Moreover, many events that might occur in the case would be defaults under the loan agreement, permitting CIT immediately to foreclose. These included conversion of the case to a Chapter 7 liquidation, or the appointment of a trustee or examiner;[296] filing a plan or disclosure statement which did not provide for the full payment of the DIP loan or to which CIT did not agree;[297] making any challenge to CIT's prepetition claims[298] or liens;[299] the entry of an order granting relief from the stay permitting other creditors to foreclose on any of the debtor's assets in excess of $50,000;[300] or any change in senior management of the debtor.[301]

Second, various provisions limited scrutiny of CIT's conduct in the LBO, which apparently contributed to the need for bankruptcy in the first place.[302] This would deter participation by litigation and prevent the estate from recovering money or assets from CIT for distribution to other creditors. For example, if CIT's lien were not perfected, it would

292. Final DIP Order, *supra* note 280, ¶ 50.

293. Exhibit A: Senior DIP Credit Agreement § 7.11, *In re* Jevic Holding Corp., No. 08-11006 (BLS) (Bankr. D. Del. May 20, 2008) [hereinafter DIP Loan Agreement]. The form of DIP Loan Agreement was attached to the DIP Motion, *supra* note 32, but the final, executed agreement does not appear to be available. This discussion assumes that the executed version was the same as that presented to the bankruptcy court.

294. DIP Loan Agreement, *supra* note 293, § 7.12.

295. *Id.* § 7.15.

296. *Id.* § 8.7(a).

297. *Id.* § 8.7(c).

298. *Id.* § 8.7(e).

299. *Id.* § 8.7(l).

300. *Id.* § 8.7(i).

301. *Id.* § 8.8.

302. The Final DIP Order provides that:

> [E]ach of the Debtors has waived and shall be barred from (i) challenging the amount, validity, extent, perfection, or priority or seeking to set aside, avoid, offset, or subordinate any of the Prepetition Indebtedness or any Liens or security interests . . . and (ii) asserting any other claims or causes of action against the [lenders] including, without limitation, claims for lender liability or pursuant to sections 105, 510, 544, 547, 548, 549 or 550 of the Bankruptcy Code.

Final DIP Order, *supra* note 280, ¶ 39. The timing is ironic. The debtor first granted this waiver at the outset of the case. Yet, one of the reasons given for the contested settlement was the cost and difficulty of determining the merits of any of these causes action, which, by that point, had been subject to several years of investigation and litigation. How could the DIP have known at the outset of the case that it did not have claims that, at the end of the case, the major parties agreed were too complex and difficult to litigate to term?

not be enforceable at all in bankruptcy, but the DIP loan prevented the debtor from challenging it on these grounds.[303] Similarly, and more concretely, the estate had fraudulent transfer claims against CIT that were ultimately asserted by the creditors' committee—but management for the debtor had to waive the debtor's right to pursue those claims directly.[304] While the creditors' committee had authority to investigate CIT's prebankruptcy actions, it had only seventy-five days to do so,[305] and any lawsuit that succeeded was an automatic default under the DIP financing.[306]

Third, and more prosaically, lawyers for the creditors' committee would have a limited budget to conduct any investigation,[307] and could not use proceeds of the DIP financing to pay counsel for such investigations.[308] Because the assets of the estate were fully encumbered by the DIP financing, there would be no cash in the estate other than proceeds of the DIP financing with which to pay counsel to the creditors' committee to sue CIT. These limits may have played a role in committee counsels' ultimate decision to recommend the structured dismissal that was later reversed by the Supreme Court. Without it, it was not clear how they would have been paid; with it, it was.

---

303. 11 U.S.C. §§ 544(a), 551 (2012). If those loans were unperfected, it means that CIT would have had no priority at all.

304. Even if the LBO liens were not fraudulent transfers, payments or liens CIT received in connection with the LBO might have been avoidable as fraudulent transfers or, if occurring within ninety days of the bankruptcy, preferential transfers. *Id.* §§ 544, 547–48.

305. Final DIP Order, *supra* note 280, ¶ 39.

306. *Id.* ("The entry of an order of the Bankruptcy Court, which results in the impairment of the [prepetition loan and security interest] shall constitute an immediate Event of Default under this Final Order and the Senior DIP Financing Documents.").

307. The Final DIP Order also approved a "Carve-Out" for professional fees of $1.365 million for estate professionals, and the lenders' professionals. *Id.* ¶ 34. For a discussion of carveouts, see Richard B. Levin, *Almost All You Ever Wanted to Know About Carve Out*, 76 AM. BANKR. L.J. 445, 449 (2002) (maintaining that while "the carve out protects the professionals . . . it also may benefit the secured creditor, which might have concluded that an orderly liquidation or restructuring process is likely to result in the highest net recovery on its claim, even after payment of carve out expenses"); Charles W. Mooney, Jr., *The (Il)Legitimacy of Bankruptcies for the Benefit of Secured Creditors*, 2015 U. ILL. L. REV. 735, 750 (noting that "[i]t is not unusual for a secured creditor to carve out from proceeds of its collateral funds to cover professional fees and other administrative expenses").

308. Final DIP Order, *supra* note 280, ¶ 41.

> Notwithstanding anything herein to the contrary, none of the Proceeds of the Senior DIP Financing may be used by any of the Debtors, the Committee, or any other person or any entity to (i) object to or contest in any manner the Senior DIP Indebtedness, or to assert or prosecute any actions, claims, or causes of action against any of the Senior DIP Indebtedness, or to assert or prosecute any actions, claims, or causes of action against any of the Senior DIP Agent . . . .

Id.

In the structured dismissal hearing in *Jevic*, the bankruptcy judge ruled that he would approve the settlement of the fraudulent transfer suit due to the "dire circumstances"[309] of the case: "[a] confirmable Chapter 11 plan was unattainable. And there would be no funds to operate, investigate, or litigate were the case converted to a proceeding in Chapter 7."[310] This may have been true. But a review of the terms of the DIP financing in *Jevic* suggests that this was virtually inevitable from the outset because the debtor's assets were fully encumbered and could not be used to pay any estate professionals—committee counsel or counsel to the debtor in possession—to challenge the senior lenders' prebankruptcy transactions or any estate officers, such as a trustee, in the event the case was converted to a liquidation under Chapter 7. Moreover, CIT's "veto" rights under the DIP loan gave it the power to decide how the rest of the case would proceed, including its exit path, the technical problem ultimately before the Supreme Court.

2. *Predictability and Procedural Integrity in the* Jevic *DIP Loan*

Arrogating power to senior creditors under DIP loans also threatens predictability and procedural integrity. If important decisions in the case are left to the whim of a single creditor, then it may be more difficult for other stakeholders to predict outcomes and bargain around them. Too much power may corrupt, and that may be the problem we see developing with DIP lending.

As a DIP lender, the senior creditor may initially agree with other parties to attempt a reorganization in place through a Chapter 11 plan. But if it becomes impatient with the process or simply disagrees with management's strategy, the DIP loan would give the lender the power to call the loan, making it virtually impossible for the debtor to take meaningful action. This may eliminate residual value that would otherwise flow to junior creditors. Even if a court were somehow able to preclude a DIP lender from exercising its rights under the DIP loan, its contractual leverage should lead most participants to think twice before proceeding without the DIP lender's blessing.

Consolidating this much power in the hands of a single stakeholder threatens the integrity of the process. The mechanisms built into the *Jevic* DIP loan deterred challenges to CIT's conduct in connection with

309. Czyzewski v. Jevic Holding Corp., 580 U.S. __, 137 S. Ct. 973, 982 (2017) ("The court accordingly decided to grant the motion in light of the 'dire circumstances' facing the estate and its creditors.").

310. *Id.*

the LBO, and efforts to avoid impermissible transfers of property of the debtor. If lenders such as CIT are able to use DIP financings to shield themselves from liability, there will be little reason to respect fraudulent transfer and similar law designed to protect creditors. Senior creditor power exercised through DIP loans enables them to turn the process on its head, to insulate themselves from scrutiny by the very creditors the system was meant to protect.

To be sure, a single dominant secured party may also present economies of scale not available with multiple lenders. Fights between different tranches of secured debt suggest that there is not necessarily strength in numbers. So, the point is not that we should eliminate priority, or even its vesting in a single senior creditor. Rather, the point is that that creditor should not be able to use its seniority to materially impair participation, predictability, and the integrity of the process.

C. *Asset Sales*

Although Chapter 11 was designed to encourage going concerns to reorganize "in place," Congress recognized that a debtor may need to sell assets before a plan is confirmed. As noted above, "363 sales" are common means of restructuring debtors, and may well be justified in many cases.[311] *Jevic* was one such case. Problems of process quality can arise, however, when senior creditors insert themselves into the sale process. Sales have become popular with senior creditors because they may enable the creditor to cash out quickly and, perhaps equally important, to use their leverage to influence the sale process in at least three ways.[312]

1. *Sale Timing*

First, the senior creditor may seek to control the timing of the sale through its position as DIP lender. Usually, this means sooner rather than later. This takes us back to the Chapter 11 bankruptcies of

---

311. 11 U.S.C. § 363(b)(1) (2012) ("The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate . . . .").

312. There are different views about how often senior creditors actually demand sales. *Compare* Baird, *supra* note 13, at 811 ("The senior creditors can often use their ability to withhold financing as a lever to ensure the speedy sale happens."), *with* Westbrook, *supra* note 261, at 844 ("The conventional narrative assumes that cases that are controlled by secured creditors are likely to involve section 363 sales. That part of the narrative also appears open to serious question. Cases with a high percentage of secured debt seem less likely to have sales of assets . . . ."). But, as shown in this subpart, there is little question that senior creditors can significantly influence the process, if they wish to do so.

automakers Chrysler and General Motors.[313] As noted above, in these cases, the government had become the automakers' senior lenders under DIP loans in the respective cases. In *Chrysler*, the United States and Canadian governments facilitated negotiations with Fiat and Chrysler to produce a sale agreement dated April 30, 2009, the same day that Chrysler filed its Chapter 11 petition.[314] GM filed its Chapter 11 petition on June 1 and, on the same day, the court approved its proposed sale transaction under section 363.[315] The Bankruptcy Court in *GM* determined that, like *Chrysler*, there was a "need for speed" in approving the 363 Transaction:

> Other than the U.S. Treasury and [Canadian government], there are no lenders willing and able to finance GM's continued operations. Similarly, there are no lenders willing and able to finance GM in a prolonged Chapter 11 case. The continued availability of the financing provided by the Treasury is expressly conditioned upon approval of [the 363 Motion] by July 10, and prompt closing of the 363 Transaction . . . . Without such financing, GM faces immediate liquidation.[316]

The problem with speed is that it is often unclear whether the sale maximizes value because it stanches the bleeding, or is instead evidence of collusion between senior creditors, managers and purchasers. Assessing the automaker cases, Professors Jacoby and Janger recently observed that "[t]he answer is a little bit of both."[317]

This suggests that courts should be mindful of the participatory effects of the pace they permit. Severe time constraints may limit shopping of a debtor's assets and potential purchasers' efforts to conduct due diligence. These participatory failures may, in turn, depress bids. Although concerned creditors can object to the sale process, and the sale itself, the standard that governs such sales, as noted above, is quite loose: "business judgment."[318] Absent evidence of collusion—which takes time to ascertain—it seems unlikely that an individual creditor could object effectively. A creditors' committee would have standing to object, but speed will also limit its effectiveness. Appealing a sale order is difficult because winning bidders enjoy special protections to promote

---

313. *In re* Chrysler LLC, 576 F.3d 108, 111–12 (2d Cir.), *vacated as moot sub nom.* Ind. State Police Pension Tr. v. Chrysler LLC, 558 U.S. 1087 (2009) (mem.).

314. *Chrysler*, 576 F.3d at 111–12 (2d Cir. 2009).

315. GM Debtors' Motion, *supra* note 187.

316. *In re* Gen. Motors Corp., 407 B.R. 463, 484 (Bankr. S.D.N.Y. 2009).

317. Jacoby & Janger, *supra* note 276, at 866.

318. *See* discussion *supra* section I.B.1.

closure. Bankruptcy sales are usually final and difficult to appeal absent a showing of collusion.[319]

It may seem counterintuitive that a senior creditor would rush a sale that depresses bids for the assets. But, this might happen either because the senior creditor believes the asset values are declining—the "ice cube is melting," in the vernacular—or, as discussed below, it would prefer to acquire the assets itself, through a credit bid.

A senior creditor's power to control timing also reduces predictability. Whether there will be a quick sale may—or may not—be clear from the outset. In any case, if the senior creditor has the power under a DIP loan agreement to control when the sale occurs, then it—and not the interests of other stakeholders or participants, such as potential purchasers—will strongly influence when the sale occurs. It may be difficult to know the senior creditor's views or motivations—or that the senior creditor's strategy will necessarily be sound. Priority may confer procedural power, but there is no evidence that priority reduces a senior creditor's fallibility.

Speed also threatens procedural integrity because it will be difficult for parties to know whether there was collusion among the senior creditor, the purchaser, and/or select other creditors. For example, a serious concern raised in the automaker cases was that the senior creditors were able to use their leverage not only to rush the sales, but also to effectively foreclose any scrutiny of the "winners" and "losers" that were picked among the debtors' suppliers. Some suppliers were entitled to continue to sell to the post-bankruptcy carmakers, and they would obviously fare better than those who did not. Were those deals the product of arms' length bargaining or illicit pressure? The need for speed and finality made it practically impossible to anticipate or challenge the outcomes there. As noted above, while it may be possible to view *Jevic* as resolving unfinished business from *Chrysler*, it does not change the fact that many were left queasy about the integrity of the process there.[320]

2. Credit Bidding

A second way that senior creditors may control the sale process will be through "credit bidding." Bankruptcy Code section 363(k) permits a secured creditor to use the debt owed to it as "credit" toward the purchase price for the debtor's assets if the creditor happens to be the

319. 11 U.S.C. § 363(m) (2012).

320. *See, e.g.*, Brubaker & Tabb, *supra* note 16, at 1378; Roe & Skeel, *supra* note 28.

purchaser.[321] The premise is straightforward: instead of using cash, the creditor can bid for the debtor's assets in the amount of its claim against the debtor.[322] If the credit bid is the winning bid, the creditor can take possession of the collateral[323] and offset the amount of her claim against the purchase price of the property.[324]

A secured creditor's right to credit bid is not absolute and may be limited "for cause."[325] As in other contexts, the Bankruptcy Code does not define the term "cause," but as with timing, the chief concern has been distributive, that the right to credit bid may chill competitive bidding.[326] Proponents of credit bidding argue that it promotes competition because other potential bidders will view the senior creditor's bid as an informed signal of confidence in the value of the debtor's assets.[327] But this assumes that the senior creditor knows more about the assets than potential purchasers.[328] The senior creditor may, however, be wrong, and other purchases will not know. Fearing that the "ice cube is melting," other potential bidders may (wrongly) assume that the senior creditor is undersecured, and there would be no sense in

321. 11 U.S.C. § 363(k) ("At a sale under subsection (b) of this section of property that is subject to a lien that secures an allowed claim, unless the court for cause orders otherwise the holder of such claim may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property.").

322. Randall Klein & Danielle Juhle, *Majority Rules: Non-Cash Bids and the Reorganization Sale*, 84 AM. BANKR. L.J. 297, 317 (2010). Creditors may also cash bid for any residual amount necessary to purchase the property. Vincent S. J. Buccola & Ashley C. Keller, *Credit Bidding and the Design of Bankruptcy Auctions*, 18 GEO. MASON L. REV. 99, 104 (2010).

323. Quality Props. Asset Mgmt. Co. v. Trump Va. Acquisitions, LLC, No. 3:11-CV-00053, 2012 WL 3542527, at *7 n.13 (W.D. Va. Aug. 16, 2012) ("By using its credit to outbid a sale to a third party at a lower price, the secured creditor can choose to take possession of its collateral . . . ."); Buccola & Keller, *supra* note 322, at 102.

324. 3 COLLIER ON BANKRUPTCY ¶ 363.09 (Richard Levin & Henry J. Sommer eds., 16th ed. 2018); *see also* Bellair, Inc., v. Aviall of Tex., Inc., 819 S.W.2d 895, 899 (Tex. App. 1991) ("Setoff is the doctrine of bringing into the presence of each other the obligations of A to B and B to A, and by the judicial action of the court making each obligation extinguish the other." (quoting Nalle v. Harrell, 12 S.W.2d 550, 551 (Tex. 1939))).

325. *In re* Olde Prairie Block Owner, LLC, 464 B.R. 337, 347–48 (Bankr. N.D. Ill. 2011).

326. *In re* Phila. Newspapers, LLC, 599 F.3d 298, 316 (3d Cir. 2010); *In re* Fisker Auto. Holdings, Inc., 510 B.R. 55, 60 (Bankr. D. Del. 2014); *In re* The Free Lance-Star Publ'g Co. of Fredericksburg, 512 B.R. 798, 806 (Bankr. E.D. Va. 2014).

327. Buccola & Keller, *supra* note 322, at 100.

328. *See, e.g.*, *In re* Miami Gen. Hosp., Inc., 81 B.R. 682, 688 (S.D. Fla. 1988) ("FABT's credit bid escalated the bidding and enabled the Trustee to realize an additional $450,000.00 more than General Health's bid of $15,050,000.00.").

attempting to submit a topping bid.[329] Or, they would not view the assets as having sufficient value to justify the cost of investigation.

As with a senior creditor's ability to influence the speed of a sale, credit bidding creates risks of error and expropriation. The American Bankruptcy Institute's Chapter 11 Commission recently conceded that "all credit bidding chills an auction process to some extent" but "did not believe that the chilling effect of credit bids alone should suffice as cause under section 363(k)."[330] Like super-priority DIP lending, credit bidding has the potential to undermine process values of participation, predictability, and procedural integrity.

3. *Controlling the Distribution of Sale Proceeds—"Gifting" and Property of the Estate?*

Senior creditors may also challenge *Jevic*'s process values by using their priority to manipulate what constitutes property of the estate, and thus control final distributions. In theory, the proceeds of a sale of the debtor are property of the estate, which must be distributed in order of priority unless a priority creditor consents. But, if the assets were encumbered, the proceeds would also be subject to the senior creditors' lien.[331] Senior creditors have used this property-based position to argue that their priority in the debtor's assets entitles them to make a "gift" of it to induce junior stakeholders to support a resolution that the senior creditor prefers. In theory, this is usually impermissible.[332] In practice, however, senior creditors appear to use their priority to control this aspect of the process as well.

For example, on the same day in January 2015 that *Jevic* was argued before the Third Circuit, another panel of the Third Circuit heard argument in *In re ICL Holding Co.* (*LifeCare*).[333] *LifeCare* involved a

329. Geoffrey K. McDonald, *The Road Not Taken:* RadLAX *and the Unstated Constitutional Basis and Limits of a Secured Creditor's Right to Credit Bid at a Bankruptcy Sale of Its Collateral*, 2014 ANN. SURV. BANKR. LAW 9.

330. *See* ABI REPORT, *supra* note 7, at 147.

331. U.C.C. § 9-315 (AM. LAW INST. & UNIF. LAW COMM'N 2000).

332. *Compare In re* Armstrong World Indus., 432 F.3d 507, 509 (3d Cir. 2005) (forbidding inter-class gifting), *and* DISH Network Corp. v. DBSD N. Am., Inc. (*In re* DBSD N. Am., Inc.), 634 F.3d 79, 97 (2d Cir. 2010) (same), *with* Official, Unsecured Creditors' Comm. v. Stern (*In re* SPM Mfg. Corp.), 984 F.2d 1305 (1st Cir. 1993) (permitting gifting in a Chapter 7 liquidation).

333. 802 F.3d 547 (3d Cir. 2015). Both were argued Jan. 14, 2015. *See id.*; Official Comm. of Unsecured Creditors v. CIT Grp./Bus. Credit Inc. (*In re* Jevic Holding Corp.), 787 F.3d 173 (3d Cir. 2015), *rev'd sub nom.* Czyzewski v. Jevic Holding Corp., 580 U.S. __, 137 S. Ct. 973 (2017). The *LifeCare* debtors had previously been known as "Lifecare." LifeCare Holdings, Inc. was at one time a leading operator of long-term acute care hospitals. *See In re ICL Holding Co.*, 802 F.3d at 549–50.

"quick sale" of the debtors, a healthcare provider, to its secured creditors.[334] Prior to the sale, the debtors had apparently marketed themselves to various suitors, none of whom were willing to pay more than about 80% of the outstanding secured debt. The secured creditors, on the other hand, were willing to credit bid about 90% of what they were owed, and to pay the costs of professionals, including a creditors' committee.[335] One day before going into bankruptcy, the debtors entered into an asset purchase agreement with the secured creditors.[336] Although the opinion is somewhat unclear on this, it appears that as part of the purchase agreement, and prior to the commencement of the bankruptcy, the secured creditors also deposited funds into separate escrow accounts to cover the costs of professionals and to wind down the debtor's operations.[337]

The creditors' committee and United States Government objected to the sale.[338] The committee argued that the sale was a "veiled foreclosure" that would leave the bankruptcy estate administratively insolvent, unable to pay expenses such as committee counsel's fees.[339] As in *Jevic*, the senior creditors and the creditors' committee then entered into a settlement agreement. The secured creditors agreed to deposit $3.5 million in trust for the benefit of general unsecured

---

While in Chapter 11, Lifecare was referred to as "LCI." According to Judge Ambro, "per its plan of reorganization it became 'ICL.'" *Id.* at 549 n.1. It is not entirely clear what this means. A search of the docket reveals no evidence that a plan was ever confirmed. *See* Dkt., *In re* ICL Holding Co., No. 12-13319-KG (Bankr. D. Del. Dec. 11, 2012). Instead, it appears to have been resolved by a structured dismissal similar in certain respects to that involved in *Jevic*.

334. *In re ICL Holding Co.*, 802 F.3d at 551 ("[T]he [Bankruptcy] Court described LifeCare's condition as getting progressively worse; in bankruptcy talk, it was a 'melting ice cube.'").

335. *Id.* at 550 (the secured creditors agreed to "credit $320 million of the $355 million debt they were then owed").

336. *Id.* ("filed for bankruptcy one day after entering into the Asset Purchase Agreement").

337. Judge Ambro explained:

> In addition to its credit bid, the purchaser [secured creditors] agreed to pay the legal and accounting fees of LifeCare and the Committee of Unsecured Creditors (the "Committee") and to pick up the tab for the company's wind-down costs. Because the professionals hadn't completed their work, the agreement directed the purchaser to deposit cash funds into separate escrow accounts. Any money that went unspent had to be returned to it.

Id.

338. *Id.* at 551.

339. *Id.* at 550–51. Of course, if the valuations were correct, this would appear to be true even if the bankruptcy court had not approved the sale. In that event, it seems most likely that the cases would have been dismissed and the secured creditors would have foreclosed on the debtors' assets, which might have been complicated, since the debtors had thirty-four subsidiaries, "which together operated 27 long-term acute care hospitals in 10 states and had about 4,500 employees." *Id.* at 550. A state foreclosure sale—the secured creditors' other real option—seemed considerably less efficient than a sale through bankruptcy.

creditors, skipping over the "mid-priority" tax claims of the government, which claimed that the sale would result in about $24 million in capital gains tax liability.[340] The government objected, arguing that making a distribution to junior unsecured creditors violated the absolute priority rule.[341] The bankruptcy court effectively dodged the question, however, because it found that the escrowed funds were not property of the estate at all, and thus not subject to the ordinary priority rules. Rather, "because the Settlement Agreement permits a distribution directly to the unsecured creditors from the purchaser, it is an indication that [the funds] are not property of [LifeCare's] estate[,] and as such, the absolute priority rule . . . is not implicated."[342]

The government appealed both the bankruptcy court's approval of the sale and the settlement. The issue, in substance, was whether "the escrowed funds and settlement money were proceeds paid to obtain LifeCare's assets, and thus qualify as estate property that should have been (but wasn't) paid out according to the Code's creditor-payment scheme."[343] If these funds were property of the estate, the priority rules might apply to them (a question that *Jevic* later answered affirmatively). If not, then it is not clear that any Bankruptcy Code distributive rules would apply to them. The Bankruptcy Code does not, as a general matter, affect property that is not property of the estate.[344]

Bankruptcy Code section 541(a)(1) defines "property of the estate" as "all legal or equitable interests of the debtor in property as of the commencement of the case."[345] Section 541(a)(6) provides that property of the estate includes "proceeds . . . of or from property of the estate."[346] Thus, Judge Ambro reasoned for the Third Circuit that "if either the escrowed funds or settlement sums are 'proceeds of or from property of the estate,' they qualify as estate property."[347] The government argued

---

340. *Id.* at 551 ("The Government, for its part, argued that the sale would result in capital-gains tax liability estimated at $24 million, giving it an administrative claim that would go unpaid.").

341. *Id.* at 552 (government argued that "the settlement money was property of the estate" and that "bypassing it and paying the unsecured creditors disturbed the Code's priority scheme for the payment of creditors").

342. *Id.* at 552 (alterations in original) (internal quotation marks omitted).

343. *Id.* at 555.

344. Bankruptcy has long been viewed as a process "in rem," although this is a bit of a fiction. *See* Michelle M. Harner, *The Value of Soft Variables in Corporate Reorganizations*, 2015 U. ILL. L. REV. 509; Jonathan C. Lipson, *Fighting Fiction with Fiction—The New Federalism in (A Tobacco Company) Bankruptcy*, 78 WASH. U. L.Q. 1271 (2000).

345. 11 U.S.C. § 541(a)(1) (2012).

346. *Id.* § 541(a)(6).

347. *In re ICL Holding Co.*, 802 F.3d at 555.

that the settlement proceeds were property of the estate because "the secured lenders' payment to the Committee was in substance an increased bid for LifeCare's assets."[348]

Judge Ambro rejected this. While it was "true that the secured lenders paid cash to resolve objections to the sale of LifeCare's assets, that money never made it into the estate."[349] Rather, relying on the analysis of the bankruptcy court in *In re TISC, Inc.*,[350] he reasoned that where "the purchaser's 'funds [were] not proceeds from a secured creditor's liens, [they] do not belong to the estate, and will not become part of the estate.'"[351] So, too, here:

> [T]he secured lender group, using that group's own funds, made payments to unsecured creditors . . . . [T]he settlement sums paid by the purchaser were not proceeds from its liens, did not at any time belong to LifeCare's estate, and will not become part of its estate even as a pass-through.[352]

Contra *Jevic*, Judge Ambro in *LifeCare* believed that there was no property that was clearly property of the estate, available for distribution to unsecured creditors.

In *LifeCare*, the government had also objected to the treatment of the professional fees and wind-down expenses, which had been escrowed by the senior creditor prior to bankruptcy and which, Judge Ambro observed, presented "a more difficult question."[353] The government had argued that these, too, had to be considered property of the estate because they were explicitly made part of the purchase price paid to the debtor prior to the bankruptcy.[354] Although Judge Ambro acknowledged that "aspects of the Government's argument are factually correct, we cannot ignore the economic reality of what actually occurred."[355]

The "economic reality," Judge Ambro reasoned, was that the secured creditors purchased all of the debtors' assets, including their cash. While some of that cash was to be used to consummate the transaction, it was

348. *Id.*

349. *Id.*

350. 393 B.R. 71 (Bankr. D. Del. 2008).

351. *In re ICL Holding Co.*, 802 F.3d at 556 (quoting *In re TSIC*, 393 B.R. at 77).

352. *Id.* at 555–56.

353. *Id.* at 556.

354. *Id.* ("The Government urges us to reverse that ruling because the funds were listed in subsections 3.1(a) and (b) of the Asset Purchase Agreement as part of the purchase price (indeed, they were called '[c]onsideration') for LifeCare's assets and thus qualify as estate property under Bankruptcy Code § 541(a)(6) (including as property of the estate 'proceeds' from a debtor's asset sale).").

355. *Id.*

held in escrow, not generally available to the debtors, and any residual was to revert to the purchasers, and not remain with the debtors. Moreover, and perhaps more basically, because the senior creditors were under-secured credit bidders, "once the sale closed, there technically was no more estate property."[356]

Judge Ambro "recognize[d] that, in the abstract, it may seem strange for a creditor to claim ownership of cash that it parted with in exchange for something."[357] Here, however, he maintained that "it makes sense" because the escrowed funds in question were "to facilitate . . . a smooth . . . transfer of the assets from the debtors' estates to [the secured lenders] by resolving objections to that transfer."[358] "To assure that no funds reached LifeCare's estate, the secured lenders agreed to pay cash for services and expenses through escrow arrangements."[359]

LifeCare is a difficult and troubling decision. Some may think that *Jevic* negates it, because *Jevic* in substance forbad what *LifeCare* permitted. That, however, may be a hasty conclusion. *LifeCare* answered a different question: what was property of the estate to begin with?[360] *Jevic* did not address this, instead assuming (correctly) that the payments to settle the estate's fraudulent transfer suit were property of the estate, a point Judge Scirica made explicitly in his dissent in the court of appeals and that no one seriously challenged thereafter.[361] *Jevic* may be about priority, whereas *LifeCare* is about property of the estate. Whatever

---

356. "Put another way," he explained the following:

> [G]etting $320 million of its secured debt forgiven resulted in the secured lender group getting all the property of LifeCare. This is an important point. The Government's argument presumes that any residual cash from the sale—namely the monies earmarked for fees and wind-down costs—would become property of LifeCare. . . . But that is impossible because LifeCare agreed to surrender all of its cash. And, per the sale order, whatever remains of the $1.8 million in escrow goes back to where it came from—the secured lenders' account (as indeed happened by the time of oral argument to over $800,000 placed into escrow). Thus, as a matter of substance, we cannot conclude that the escrowed funds were estate property.

Id.

357. *Id.* at 557.

358. *Id.* (alterations in original) (internal quotation marks omitted).

359. *Id.*

360. Courts since *Jevic* seem untroubled by the holding in *LifeCare*. *See, e.g.*, Hargreaves v. Nuverra Envtl. Sols., Inc. (*In re* Nuverra Envtl. Solutions., Inc.), No. 17-10949-KJC, 2017 WL 3326453, at *3 (D. Del. Aug. 3, 2017) (citing *LifeCare* for proposition that a "gift from senior lenders to certain, but not all, classes of general unsecured creditors" is permissible).

361. Official Comm. of Unsecured Creditors v. CIT Grp./Bus. Credit Inc. (*In re* Jevic Holding Corp.), 787 F.3d 173, 188 (3d Cir. 2015) ("Critical to this analysis is the fact that the money paid by the secured creditors in the settlement was property of the estate."), *rev'd sub nom.* Czyzewski v. Jevic Holding Corp., 580 U.S. __, 137 S. Ct. 973 (2017).

effect priority has is not relevant to property that is not property of the estate.[362]

But *LifeCare* suggests that priority *does* confer on senior secured creditors the power to influence the determination of what is property of the estate under some conditions, and this is problematic. Both the prepetition escrow and post-petition trusts contained funds that could have been proceeds of property of the estate, because "proceeds" includes property received on account of, or arising from, property of the estate.[363] Perhaps because the latter resulted from settling the committee's objection, they were somehow different than the proceeds of the fraudulent transfer settlement in *Jevic*. But that seems oddly formalistic: in both *LifeCare* and *Jevic*, funds were paid to resolve rights asserted on behalf of the estate. It is not clear why they would have been exclusively property of the senior creditor in *LifeCare* but property of the estate in *Jevic*.

Yet, it is not hard to see why the Third Circuit believed that the exigencies of the case required the court to accommodate the deal the secured creditors and debtors had crafted. The *LifeCare* debtors operated twenty-seven long-term acute care hospitals in ten states and had about 4,500 employees.[364] If the value of the debtors was in fact below the amount of the senior claims, the senior creditors were undersecured; there would have been no equity in the estate with which to pay any unsecured creditors, whether priority or otherwise. The fact that the important transactions were structured before and outside bankruptcy meant, at least to Judge Ambro, that these transactions determined the size and shape of the estate in bankruptcy. It appears that the senior creditors largely called these shots, and because they were undersecured, no one was in a position to challenge this.

All of this would seem to be in tension with *Jevic*'s process values. The *LifeCare* deal as structured may have been meant "to facilitate . . . a smooth . . . transfer of the assets from the debtors' estates to [the secured lenders] by resolving objections to that transfer."[365] But, it may also have been structured to facilitate a fraudulent or preferential transfer or, as the

---

362. *But see* David R. Kuney, *Implications of* Czyewski v. Jevic*: Will* Jevic *Alter the Delicate Leverage of Bankruptcy Bargaining?*, *in* AM. BANKR. INST., NATIONAL CONFERENCE OF BANKRUPTCY JUDGES: EDUCATIONAL MATERIALS 8, 16–19 (2017), https://ncbjmeeting.org/pyny9804/NCBJ17_ABI_Materials_Book_5%20programs.pdf [https://perma.cc/Z5L3-R7MH] (discussing unpublished opinion in *In re Constellation Enterprises, LLC*, No. 1:17-cv-00757-UNA (D. Del.), applying *Jevic* to property that was arguably not property of the estate).

363. U.C.C. § 9-102(a)(64) (AM. LAW INST. & UNIF. LAW COMM'N 2010).

364. *In re ICL Holding Co.*, 802 F.3d at 550.

365. *Id.* at 557 (alterations in original) (internal quotation marks omitted).

government insinuated, a way to avoid paying capital gains tax. Whether the deal could have been challenged on those grounds depends on the value of the debtor's assets and the quality of management's efforts to market the debtors. Here, perhaps the court took comfort in the fact management apparently marketed the debtors to over 100 potential purchasers prior to agreeing to the "sale" to the secured creditors and could find no better deal.[366]

But, given the structure of the sale, there was little way to check this. Participation involves, among other things, scrutiny. That is ordinarily the job of counsel to the creditors' committee. It is not, however, clear how a committee could do so under these conditions. While the committee objected to the sale, it is unlikely that committee counsel was able to investigate and challenge management's prebankruptcy efforts to sell the debtors. Nor do we know whether an effort to market and sell the debtors through a more conventional section 363 sale in bankruptcy (rather than before) might have produced a price that topped the credit bid and produced a better return to the estate. Nor is it clear whether committee counsel could have investigated and challenged prepetition payments the senior creditors may have received. Under ordinary rules regarding the avoidance of preferential transfers, property of the debtors that they received during the ninety days before bankruptcy may have been recoverable by the estate.[367] If nothing else, the agreement to sell the debtor's assets one day before bankruptcy would have been a transfer that warranted this scrutiny. These are all forms of participation that the deal structure in *LifeCare* made difficult, if not impossible.

Moreover, giving the senior creditor the power to direct the sale proceeds undercuts the participatory logic of *Jevic*. If participation includes the power to decide how final distributions are made, then permitting the senior creditor to pick and choose which other creditors are paid via the Chapter 11 process is problematic because that process exists in part to give all stakeholders a say in what becomes of the debtor's assets. The senior creditor that wants to control the distribution of a debtor's assets may do so under generally applicable state law, such as the Uniform Commercial Code, outside of bankruptcy. It is difficult to justify the existence of the Chapter 11 process, however, if it merely serves the distributive goals of senior creditors.

LifeCare would also seem to tolerate a level of unpredictability that is problematic under *Jevic*, for two reasons. First, vesting a single creditor

366. According to the opinion, the debtors were marketed to 106 potential purchasers. *Id.* at 550.

367. 11 U.S.C. § 547(b) (2012).

group with the power to pick winners, rather than the vote of the whole, or resorting to absolute priority, makes it hard for creditors to know ex ante whether (or what) they will be paid. The senior creditor's power to control whether there was a valuation and then who got paid what from the settlement meant that final distributions were at the whim of a single group of secured creditors. Second, the Third Circuit's approach to property of the estate is destabilizing. Giving senior creditors the power to structure transactions in order to enable them to determine what is and is not property of the estate cedes courts' power to make that determination independently. While "property" is sometimes a contentious doctrinal category, its use in *LifeCare* creates greater uncertainty for future cases, where we can expect senior creditors to use similar tactics to control the reorganization process.

And all of this threatens the procedural integrity of the Chapter 11 process. It is hard to look at the deal in *LifeCare* and avoid the conclusion that it was structured to avoid taxes. Maybe it would not survive scrutiny under tax law. But bankruptcy law and practice should not tolerate that result either. It is perhaps ironic in that the U.S. government was the senior creditor in the automaker cases, where it used its senior status to force through quick sales and pick and choose "winners" among the debtors' creditors. Here, the U.S. government, as taxing authority, was on the other side, and understandably unhappy about it. Perhaps, the *LifeCare* court believed, what is sauce for the goose is sauce for the gander.

V. OPPORTUNITIES AFTER *JEVIC*

Still, *Jevic* is now the law of the land, and its process-value framework may limit *LifeCare*'s property-based logic. Determining whether it does so presents one of several opportunities that *Jevic* creates for scholars and practitioners. This part briefly sketches several others.

A. Opportunities for Scholars

Jevic's process values invite observers to investigate the relationship between priority and process. For those who are empirically minded, consider some questions:

- How does *Jevic* affect the supply of, and demand for, various resolution mechanisms in bankruptcy? Does *Jevic* raise the cost of using Chapter 11 by requiring more plans and fewer structured dismissals after *Jevic*? Or do crafty lawyers devise new mechanisms, suggested by *LifeCare*, that may get around *Jevic*'s narrowly tailored holding, undercutting its process values along the way?

- How does *Jevic* affect resource allocation within Chapter 11 cases? Do we observe smaller DIP loans, larger carveouts, or other mechanisms that alter estate liquidity after *Jevic*? The process values *Jevic* seems to have in mind are not costless. Paying for them may require the use of assets otherwise subject to a lien.
- How does *Jevic* affect governance in reorganization? Does it result in increased committee power? Or does it fragment that power, as individual creditors use *Jevic*'s consent standard to assert strategic objections, perhaps conflicting with the goals of committee counsel?
- How does *Jevic* affect the 363 sale? Do we find greater market participation after *Jevic*? Or do the dynamics of sales remain unchanged?
- How does *Jevic* affect "gifting," whether under plans or otherwise? One reading of *Jevic* may be that it forbids gifting because it requires absolute priority and individuates consent: even a confirmed plan could not overcome it. Yet, the property-based logic of *LifeCare* may be compelling to some. If so, then the important question is the value of the collateral—a determination that the secured creditor may be able to control.
- Does *Jevic* affect aggregate use of Chapter 11? If *Jevic* reduces the value of Chapter 11 to senior creditors because it constrains their control, perhaps senior creditors will increasingly foreclose outside bankruptcy?

For those who are more conceptually oriented, *Jevic* squarely presents in bankruptcy the question scholars of broader procedural domains have wrestled with for many years: how do we compare the costs and benefits of alternative processes?[368] In its modern form, the question is oriented around the extent to which contract can or should displace ostensibly "mandatory" rules of civil procedure and evidence. Proponents of "contract procedure" suggest that permitting parties to customize adjudicative options promotes efficient outcomes both for the parties themselves and courts.[369] Opponents worry about both distributive

368. Isaac Ehrlich & Richard A. Posner, *An Economic Analysis of Legal Rulemaking*, 3 J. LEGAL STUD. 257, 257 (1974) (examining the "conditions under which greater specificity or greater generality is the efficient choice" in the legal process based on a cost-benefit analysis).

369. *See, e.g.*, Jay Brudz & Jonathon M. Redgrave, *Using Contract Terms to Get Ahead of Prospective eDiscovery Costs and Burdens in Commercial Litigation*, 18 RICH. J.L. & TECH. 13

infirmities—the weak will unwittingly contract away their right to discovery, for example—and public values such as the inherent merits of the adversary system, the creation of a stock of accessible precedent, and so on.[370] Although this is a large and growing body of literature, it has made no apparent headway among bankruptcy scholars.[371] If *Jevic* is telling us something about the relationship between (private) priority rights and (public) process values, it invites a richer assessment of the relationship between these two bodies of scholarship.

B. *Opportunities for Practitioners*

Jevic has already affected practice, leading at least one court to refuse to approve a structured dismissal on grounds that priority creditors objected.[372] Some worry that *Jevic* may threaten other practices that have developed in Chapter 11, on grounds that they defy an "absolute" theory of priority, such as "first-day" orders that prepay wages and vendors "critical" to the debtors' survival.[373] While these concerns seem somewhat exaggerated—*Jevic* was careful to speak only about *final* distributions[374]—it remains true that junior stakeholders, and those who would advocate for them, are often at odds with senior creditors, and that the inflection points are procedural moments: DIP financing and asset sales.

While there are litigated solutions to these problems, I have argued elsewhere that under the right conditions, contract may be a superior

(2012); Michael L. Moffitt, *Customized Litigation: The Case for Making Civil Procedure Negotiable*, 75 GEO. WASH. L. REV. 461 (2007); Robert J. Rhee, *Toward Procedural Optionality: Private Ordering of Public Adjudication*, 84 N.Y.U. L. REV. 514 (2009); Robert E. Scott & George G. Triantis, *Anticipating Litigation in Contract Design*, 115 YALE L.J. 814, 856–78 (2006).

370. David Marcus, *The Perils of Contract Procedure: A Revised History of Forum Selection Clauses in the Federal Courts*, 82 TUL. L. REV. 973 (2008); Judith Resnik, *Procedure as Contract*, 80 NOTRE DAME L. REV. 593 (2005) (focusing largely on post-dispute contracting); David H. Taylor & Sara M. Cliffe, *Civil Procedure by Contract: A Convoluted Confluence of Private Contract and Public Procedure in Need of Congressional Control*, 35 U. RICH. L. REV. 1085 (2002); Elizabeth Thornburg, *Designer Trials*, 2006 J. DISP. RESOL. 181.

371. An earlier hint came from Steve Schwarcz who argued plausibly that "when a debtor and all of its creditors agree to a procedure contract, there is little question that the contract should be enforced." *See* Steven L. Schwarcz, *Rethinking Freedom of Contract: A Bankruptcy Paradigm*, 77 TEX. L. REV. 515, 600 (1999). While true, this describes idealized conditions that almost never occur in bankruptcy, and so cannot solve the problems the system faces.

372. *In re* Fryar, 570 B.R. 602, 610 (Bankr. E.D. Tenn. 2017).

373. *See, e.g.*, Georgakopoulos, *supra* note 3, at 934–36.

374. *See, e.g.*, Czyzewski v. Jevic Holding Corp., 580 U.S. __, 137 S. Ct. 973, 984 (2017) (forbidding payments approved by the lower courts as "the exact kind of nonconsensual priority-violating final distributions that the Code prohibits in Chapter 7 liquidations and Chapter 11 plans").

basis for reordering in bankruptcy. The bench and bar in large bankruptcies form a "contracting environment," a fairly discrete universe of repeat players.[375] These relationships are a double-edged sword: they might invite collusive conduct that offends *Jevic*, or they may create opportunities for innovation—or both. Channeled properly, they can help to address the problems of expropriation and error that dog corporate reorganization.

1. Case Financing After Jevic

Consider first adjustments to the design of case financing agreements. As noted above, these seem to be the key mechanism by which senior creditors seize control. Participants can avoid some of the process problems that led to *Jevic* through broader carveouts. Carveouts in bankruptcy are sometimes viewed as the price that senior lenders must "pay to play."[376] If *Jevic* induces participants to rethink DIP loans like the one there, which hog-tie the debtor at the outset, they may conclude that a larger carveout is the solution. In the past, courts seemed to take the position that DIP loans had to include generous carveouts.[377] Bankruptcy judges cannot, however, force senior creditors to grant carveouts. They can seek to persuade the DIP lender to make these concessions. Moreover, they can threaten to convert or dismiss the case if the senior creditors do not accede. But that may be a game of chicken bankruptcy judges do not want to play.

Similarly, courts should consider approving DIP loans in smaller increments. It is not clear why courts must approve large DIP loans on an "emergency" basis at the outset of a case. As seen in *Jevic*, while there may have been an urgent need for about $5 million to cover costs of goods in transit, the bulk of the DIP loan was apparently earmarked to pay off CIT, the prepetition senior creditor. It is hard to see how this was

---

375. Lipson, *supra* note 114, at 245 ("[L]arge Chapter 11 cases now create what Robert Scott, a leading relational theorist, would call a 'contracting environment.'" (citing Robert E. Scott, *The Promise and the Peril of Relational Contract Theory*, *in* REVISITING THE CONTRACTS SCHOLARSHIP OF STEWART MACAULAY 105, 108 (Braucher et al. eds., 2013))).

376. Mooney, Jr., *supra* note 307, at 750–51 ("Commentators have noted that in a secured creditor bankruptcy the secured creditor may be required to 'pay to play'—i.e., to carve out of its collateral funds for the benefit of general unsecured creditors.").

377. *See In re* Ames Dep't Stores, Inc., 115 B.R. 34, 38 (Bankr. S.D.N.Y. 1990) ("[I]t has been the uniform practice in this Court . . . to insist on a carve out from a super-priority status and post-petition lien in a reasonable amount designed to provide for payment of the fees of debtor's and the committees' counsel and possible trustee's counsel in order to preserve the adversary system. Absent such protection, the collective rights and expectations of all parties-in-interest are sorely prejudiced.").

an emergency. Of course, if it was an emergency, CIT already had a remedy: foreclosure in state court outside of bankruptcy. But it appears that CIT, like many senior lenders, did not want that process, preferring Chapter 11.

DIP carveouts and loan size/timing affect participation. Without an adequate carveout, committee counsel cannot effectively represent all unsecured creditors. If a debtor's assets are fully encumbered by a post-petition lien, it is not clear how effectively anyone other than the secured creditor can participate in meaningful decisions about the debtor's fate.

Moreover, there are specific terms in DIP loans that courts should forbid. Provisions that trigger defaults if the estate investigates or sues the senior creditor have no place in this context, because they undermine predictability and procedural integrity. Prohibiting committee counsel or other estate professionals from using estate funds to do so has the same effect. So too with estate waivers of claim objections, or the release of claims against senior creditors in a DIP loan.

2. Asset Sales After Jevic

Those concerned about constraints on participation in sales should consider the use of "earnouts." Sometimes called a "contingent price" agreement, an earnout provides that a portion of the purchase price in the sale of a business will be deferred until after the sale, and paid based on the post-closing performance of the business, as run by the buyer.[378] Although these can be complicated, in substance they are similar to the "ice cube bond" advocated by Jacoby and Janger.[379] Under an ice-cube bond, the purchaser would post a bond to assure that it was not underpaying due to the hasty nature of the sale. The sale would close, however, producing the closure that many deem essential to the process.

The main differences between a bond and an earnout appear to be that earnouts are more price-sensitive and better known to practitioners. The problem with ice cube bonds is the problem with all distributive decisions made under poor procedural and informational conditions: the risks of expropriation and error are high. It is not clear, for example, how or when to price the ice-cube bond, how to decide whether the estate

378. *See* Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE L.J. 239, 266 (1984) ("[A] complete earnout formula is a complicated state-contingent contract that, by carefully specifying in advance the impact on the purchase price of all events that might occur during the earnout period, substantially reduces the incentives and opportunity for the parties to behave strategically.").

379. *See* Jacoby & Janger, *supra* note 276, at 935–37 (discussing proposed timing of release of purchase-price in bankruptcy sales).

should keep it or return it to the purchaser, or how (if retained by the estate) it should be distributed. Earnouts are not perfect—parties fight about their implementation—but may be better simply because they typically involve well-understood post-closing processes that answer some of these questions. They are a familiar, process-based response to a distributive problem that would improve predictability and, perhaps, market participation in Chapter 11 sales.

As with DIP loans, senior creditors' power to control the timing of sales should also be limited. Courts should be sensitive to the participatory and predictive effects that credit bidding may have on participation in the bidding process. In cases where credit-bidding appears to deter participation, courts may now conclude that there is cause to limit or condition the credit bid. Similarly, where the senior creditor is the purchaser, it should not be permitted to control the distribution of proceeds, as happened in *LifeCare.* To do so threatens the predictability and integrity of the process because it invites collusion and unequal treatment.

CONCLUSION

Jevic is rightly viewed as the Supreme Court's most important opinion on corporate reorganization in many years. Unlike some of the Court's opinions on bankruptcy,[380] there is little doubt that *Jevic* got it right. It is a concise holding, narrowly crafted to address one overt problem—what is the right priority rule?—but in the process providing important guidance on the operation of a system that has managed trillions of dollars in claims and affected hundreds of thousands of jobs and potentially millions of lives.

It also took an important theoretical position. Behind the priority debates is a question about the efficiency of different priority rules. As explained above, these debates have largely failed to account for the procedural implications of the rule choices, or the power that senior creditors can gain using their priority. Constraining this power will not be costless. Indeed, process values generally may add cost to Chapter 11 reorganization. But this may simply mean that welfare maximization is not the only or most important value in reorganization.[381] It is one of

---

380. *See, e.g.*, Lipson & Vandermeuse, *supra* note 33, at 1186 (criticizing the Supreme Court's decision in *Stern v. Marshall*).

381. This was a point Justice Kagan seemed to recognize at the *Jevic* oral argument:

> [H]ere's two different kinds of bankruptcy schemes. One scheme just says every time you distribute assets, you have to follow the following order: one, two, three, four, five. . . . That's one Bankruptcy Code. Here's another Bankruptcy Code: It says presumptively, you have to

several important values. So long as debtors and creditors wish to use bankruptcy courts to resolve financial distress, the quality of the process by which they do so will matter, even as it may not be free.

The great bulk of scholarship on corporate reorganization focuses on distributive questions: which rules will maximize welfare by producing the greatest return for the largest number of stakeholders? While this is an appropriate ultimate question, our thinking about it too frequently ignores the procedural operation and implications of these rules. *Jevic* reveals that we should not ignore the quality of the process by which we reorganize troubled companies. The secret life of priority is process.

POSTSCRIPT

As this Article went to press, the Bankruptcy Court in *Jevic* granted the drivers' motion to convert the Chapter 11 case to a case under Chapter 7.[382] On remand from the Supreme Court, the Bankruptcy Court had sought to have the parties mediate a new settlement, but this failed.[383] Thus, nearly six years after the problematic structured dismissal was initially approved, and ten years after the debtors went into bankruptcy, the cases will be resolved by a Chapter 7 trustee.

> follow one, two, three, four, five, but if there is a Pareto-superior solution, in other words, a solution in which some people are made [better] off and nobody . . . gets a worse outcome . . . if there is such a solution, you can go with that. And that might be a completely sensible bankruptcy provision . . . . The question is whether Congress did enact it and what [respondents] can point to in the Bankruptcy Code that suggests that the continual statement that it's just one, two, three, four, five is subject to a kind of equitable exception for Pareto-superior outcomes.

Transcript of Oral Argument at 43–44, Czyzewski v. Jevic Holding Corp., 580 U.S. __, 137 S. Ct. 973 (2016) (No. 15-649), 2016 WL 7117910, at *43–44.

382. *See* Oral Ruling, *In re* Jevic Holding Corp., No. 08-01106 (BLS) (Bankr. D. Del. May 21, 2018).

383. *Id.*