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15-649

IN THE

Supreme Court of the United States

CASIMIR CZYZEWSKI, *et al.*,

Petitioners,

—v.—

JEVIC HOLDING CORP., *et al.*,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF OF *AMICI CURIAE* PROFESSORS JAGDEEP S. BHANDARI, SUSAN BLOCK-LIEB, JESSICA GABEL CINO, LINDA E. COCO, ROBERT D'AGOSTINO, IRINA J. FOX, C. SCOTT PRYOR, THERESA J. PULLEY RADWAN, NANCY B. RAPOPORT, MICHAEL SOUSA, AND LAURA M. SPITZ IN SUPPORT OF RESPONDENTS

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October 17, 2016

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INTEREST OF *AMICI CURIAE*[1]

The *Amici*[2] are law professors who have devoted their careers to the study and teaching of bankruptcy law. They represent no institution, group, or association.

Their interest in this appeal arises from the impact that the Court's decision in this case could have on negotiated settlements in future bankruptcy cases, by upsetting years of practice in which the courts have allowed exceptions to the so-called absolute priority rule (hereinafter, the "priority rule" or the "Rule"). Settlements are often the most practical and economical way of resolving contentious cases, saving valuable judicial time, and speeding up distributions to the creditors. Because the priority rule may stand in the way of achieving a settlement in some instances, the *Amici* hope to assist the Court in reaching a result that will keep the Rule from

[1] Pursuant to Rule 37 of the Rules of this Court, the *Amici* file this brief with the written consent of all parties, which is on file with this Court. No person or entity including the *Amici* or their counsel made a monetary contribution for the preparation or submission of this brief.

[2] The *Amici* are the following law professors who teach at the law schools indicated next to their names: Jagdeep S. Bhandari, Wake Forest University School of Law; Susan Block-Lieb, Fordham Law School; Jessica Gabel Cino, Georgia State University College of Law; Linda E. Coco, Barry University School of Law; Robert D'Agostino, John Marshall Law School; Irina J. Fox, Creighton University School of Law; C. Scott Pryor, Campbell University School of Law; Theresa J. Pulley Radwan, Stetson University College of Law; Nancy B. Rapoport, University of Nevada's William S. Boyd School of Law; Michael Sousa, University of Denver Sturm College of Law; and Laura M. Spitz, Cornell Law School.

unnecessarily preventing settlement in instances where, as in the instant case, the settlement would benefit the estate and the objecting parties would suffer no loss from permitting the settlement. The *Amici* also believe that because the settlement in this case would not prejudice Petitioners, the decision of the Court of Appeals below could be affirmed on that basis alone.

The *Amici* thus file this brief supporting Respondents to urge the Court to decide this appeal with these considerations in mind, and to reject Petitioners' incorrect and inflexible position that the Rule is a *per se* rule that leaves absolutely no room for any departure in any case or under any circumstances.

PRELIMINARY STATEMENT

In the case at bar, the Bankruptcy Court approved a so-called "structured dismissal" under which it both approved a settlement and dismissed a chapter 11 bankruptcy. At the time of the settlement, the estate possessed only two assets: (1) $1.7 million in cash, which was indisputably subject to the lien of Sun Capital Partners; and (2) a highly speculative fraudulent transfer claim asserted by the Creditors' Committee against Sun and CIT Group. The estate was without resources to prosecute that claim since its cash was encumbered by Sun. Unrebutted proferred testimony established that it would cost millions of dollars, aside from attorneys' fees, to bring the claim to trial. J.A. 234 (Hearing Transcript). There was also unrebutted proffered testimony that there were substantive obstacles to succeeding on that claim, including a litany of affirmative defenses and a counterclaim. *Id.* at 235. Finally, there was an unrebutted proffer of testimony that even if the litigation succeeded, there might be benefit only to administrative creditors (*i.e.*, no benefit or distribution to general unsecured or priority creditors) because there would still be an overhang of tens of millions of dollars in claims. *Id.* at 236; see 11 U.S.C. § 502(h) (2012).

Under the foregoing circumstances, the Bankruptcy Court approved a settlement under which Sun released its lien on the cash of $1.7 million, CIT paid $2 million into the estate and both were released from all claims in the fraudulent transfer litigation. The settlement therefore created a monetized $3.7 million benefit for the estate, which paid all administrative claims, and provided a modest but meaningful distribution to 1,010 general unsecured creditors. Pet. App. 39a. (Dist. Ct. opinion).

Very significantly, it is uncontested that the Bankruptcy Court properly applied the relevant legal factors in approving the settlement. As stated in the opinion below, "[n]one of the objectors contend that the bankruptcy court erred in concluding that the balance of these factors [in *In re Martin*, 91 F.3d 389, 393 (3d Cir. 1996)] favors settlement, and we agree." Pet. App. 11a (citing Bankr. Ct. opinion). Also very significantly, no-one contested the Bankruptcy Court's findings that: (1) there was "no prospect" of a confirmable chapter 11 plan, *id.* at 14–15a (quoting Bankr. Ct. opinion); (2) conversion to chapter 7 would have been unavailing since the trustee would have no funds for prosecuting the fraudulent transfer claims, Sun and CIT credibly having stated that they would not settle in a chapter 7, *id.* at 8a; (3) the omission of the Petitioners from the settlement "would not prejudice them," *id.*, and (4) the choice between approving and not approving the settlement was a choice between a "meaningful return or zero." *Id.* at 9a (quoting Bankr. Ct. opinion).

Against that background, Petitioners opposed the settlement because it did not provide a recovery for them on their WARN Act claims. They urge that the settlement is invalid as violating the so-called "absolute priority rule."

At the outset, *Amici* note that the Petitioners' objection is more academic than real. Had the settlement been disapproved as Petitioners urge, the Petitioners still would have had *no* recovery from the $1.7 million in the estate because that money would have gone to Sun, the $2 million paid by CIT would not have existed, and the estate would have been left with a hotly contested fraudulent transfer action that it had no way to fund or prosecute. Indeed, the estate's fraudulent transfer claim, its only lien-free asset, was highly speculative and remote, and found to be "effectively worthless", *id.* at 61a (Bankr. Ct. opinion), a finding which is unchallenged. In short, Petitioners are not worse off under the approved settlement than they would have been if the settlement had been rejected. Because Petitioners were not injured or prejudiced by the settlement, the decision of the Circuit Court below should be affirmed for that reason alone.

In stark contrast, however, the general unsecured and administrative creditors would have been indisputably far worse off had the settlement not been approved. In the absence of the settlement, they would have received nothing. Even the attorney for the United States Trustee, in opposing the settlement, conceded in oral argument that disapproving the settlement involved "a really ugly result. . . ." *Id.* at 23a. (3d Cir. opinion quoting Bankr. Ct. opinion). As the Bankruptcy Court recognized, and as is undisputed on appeal, the settlement provided a choice between a "meaningful return or zero." *Id.* at 9a, 61a. Nevertheless, Petitioners urge, in effect, that the so-called absolute priority rule must always apply, without exception, even when it leads to "a really ugly result," *id.* at 23a, as it indisputably would have in this case.

Amici disagree with Petitioners. For the reasons given below, the instant case is one in which the priority rule need not be followed, and, particularly in the absence of injury to the objectant, should yield to the benefit of the estate rather than blindly following the Rule and thereby arriving at a really ugly result.

SUMMARY OF ARGUMENT

As a threshold argument, *Amici* urge that the decision of the Circuit Court below should be affirmed because Petitioners were not injured or prejudiced by the settlement, under which they are not worse off than if the settlement had been rejected. Aside from that, the sole remaining issue on this appeal is whether, given the facts and record summarized above, the bankruptcy court had discretion to approve the instant settlement, even though it did not strictly follow the priority rule. The adequacy of the settlement itself is not an issue in this case. As stated by the Circuit Court below, "None of the objectors contends that the Bankruptcy Court erred in concluding that the balance of these factors favors settlement, and we agree." *Id.* at 11a (citing Bankr. Ct. opinion).

The *Amici* believe that the courts below correctly decided not to apply the Rule under the circumstances of this case. They urge that the Rule need not be followed by a bankruptcy court in approving a settlement where it finds that the benefit, if any, to an objecting party is highly speculative and remote, and where settlement demonstrably provides substantial assets to the estate, in this case a $3.7 million fund, thus making it possible for distribution to be made to most creditors who would otherwise receive absolutely nothing.

Notably, while the present case is a rare one, the *Amici* do not suggest that the bankruptcy court has unrestrained discretion to approve a settlement that deviates from the Rule. Rather, the *Amici* suggest that a bankruptcy court's discretion is limited by the requirement that it make specific findings, based on the record, that the settlement will substantially benefit the estate, that there is no realistic prospect that its disapproval would benefit an objecting party, and that there is no available basis for a party not included in a settlement to obtain a distribution in the bankruptcy if the approved settlement had been rejected by the bankruptcy court.

Several reasons support the *Amici*'s position.

First. It is fundamental that the violation of a right is not actionable if it does not result in injury. In the present case, the injury, if any, incurred by Petitioners is not cognizable, for it was highly speculative and remote at best. The principle requiring injury as an essential element of a right to relief is recognized under long-established jurisprudence universally applicable throughout the law. So strong is this principle that even the violation of a constitutional right is not actionable in the absence of injury. For this reason alone, Petitioners are not entitled to relief.

Second. Despite its moniker, the priority rule is not absolute. Even when the term was coined by Mr. Justice Douglas in *Case v. Los Angeles Lumber Products*, 308 U.S. 106 (1939) (hereinafter, "*Los Angeles Lumber*"), the priority rule really was not absolute. Subsequently to *Los Angeles Lumber*, there have been many instances in which courts have not followed the priority rule, including where no statutory text explicitly creates an exception. A prime example is the well-established doctrine permitting the substantive consolidation of a debtor estate with another debtor estate or even a non-debtor estate, resulting in out-of-priority treatment of creditors. Other examples are found in the many cases allowing cross-collateralization orders that transform pre-petition unsecured claims into secured claims, and payment of pre-petition employee wages, in order to keep the debtor's business going. A further example is the so-called critical vendor orders that transmute pre-petition claims into post-petition claims so as to secure trade credit. Not only have the courts chosen to depart from the priority rule, but Congress has chosen to do so in the Code as well. Examples include assumption of contracts where pre-petition defaults are converted from general unsecured claims into cure amounts payable as administrative expenses, and reclamation claims that convert pre-petition claims into post-petition claims.

In light of such examples showing that the Rule is not absolute, it is unsurprising that well-reasoned decisions have approved settlements departing from the Rule. See, e.g., *In re Iridium Operating LLC*, 478 F.3d 452 (2d Cir. 2007) (hereinafter "*Iridium*"), discussed *infra*. Crucially, such settlements do not violate this Court's precedent in *Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 453 (1968) (hereinafter "*TMT Trailer*") as that case, which addressed a plan under chapter X of the former Bankruptcy Act, did not extend the priority rule to settlements.

Third, the findings and conclusions made below are sufficient to uphold approval of the settlement. Further, the requisite findings, which are based on the record carefully developed at the hearing, are conceded and can no longer be controverted by any party. If, however, for any reason the Court finds them to be inadequate, the appropriate action is a remand. Significantly, in that regard, the Court simply required new hearings on valuation and insolvency by way of remand in *TMT Trailer*. Indeed the *most* that *TMT Trailer* would require in the present case is a remand. And if this Court were to believe that a further record and findings would be appropriate, the *Amici* request that the Court direct that new hearings be held to clarify why it was necessary for the settlement to deviate from the priority rule, and, if the Bankruptcy Court were again to approve the settlement, to require that court carefully to articulate its reasons for its approval. Remand was also what the court ordered in *Iridium*, 478 F.3d at 466.

POINT I

UNDER WELL-ESTABLISHED LAW, INCURRING INJURY IS ESSENTIAL TO RECOVER FOR VIOLATION OF A RIGHT; SPECULATION DOES NOT COUNT

A. Damages are awarded only if there has been injury or prejudice

Under this Court's jurisprudence, relief is not granted for violation of a right that does not cause injury or prejudice. As stated by this Court, damages are not allowable on the basis of injury that is "too remote and speculative to have any legitimate effect upon the valuation." *Tenn. Valley Authority v. Powelson*, 319 U.S. 266, 276 (1943), citing *McGovern v. New York*, 229 U.S. 363, 372 (1913); see also, *Howard v. Stillwell & Bierce Mfg. Co.*, 139 U.S. 199, 210 (1891) (stating "Tested by them, such losses were, in our opinion, rather remote and speculative than direct and immediate, resulting from the breach alleged."). *Accord*: *CQ, Inc. v. TXU Min. Co., L.P.*, 565 F.3d 268, 278 (5th Cir, 2009) (explaining damages for breach of contract are not awarded for damages that are "remote, contingent, speculative, or conjectural") quoting *City of Dallas v. Villages of Forest Hills, L.P., Phase I*, 931 S.W.2d 601, 605 (Tex. App.—Dallas 1996); *Grantham & Mann, Inc. v. Am.*

Safety Prod., Inc., 831 F.2d 596, 601–02 (6th Cir. 1987) ("As a general rule, 'damages are not permitted which are remote and speculative in nature.'") (quoting *Agricultural Services Ass'n v. Ferry-Morse Seed Co.*, 551 F.2d 1057, 1072 (6th Cir. 1977)); *Sanders v. Flanders*, 564 Fed. App'x 742, 745 (5th Cir. 2014) ("It is well settled that damages cannot be established merely through speculation or conjecture.").

This Court has made it abundantly clear that the requirement of injury is at the heart of a claim for damages for violation of a right.

> An injury, legally speaking, consists of a wrong done to a person, or, in other words, a violation of his right. It is an ancient maxim, that a damage to one, *without an injury* in this sense, (*damnum absque injuria*), does not lay the foundation of an action . . . Want of right and want of remedy are justly said to be reciprocal. Where therefore there has been a violation of a right, *the person injured* is entitled to an action.

Alabama Power Co. v. Ickes, 302 U.S. 464, 479 (1938) (quoting *Parker v. Griswold*, 17 Conn. 288, 302–03 (1864)) (emphasis added).

B. Petitioners suffered no injury from approval of the settlement

Tested by this Court's long-established jurisprudence, Petitioners have not been injured or prejudiced by the approval of the settlement at issue, and cannot prevail for that reason alone. They would not have had any recovery in this bankruptcy even if, as they demanded, the settlement had been rejected by the Bankruptcy Court and this chapter 11 case had been converted to chapter 7. This was made evident by two of the many uncontested findings made by the Bankruptcy Court and adopted by the Circuit Court below. First, it found that "there was 'no realistic prospect' of a meaningful distribution [either in chapter 7 or chapter 11] to anyone but the secured creditors unless the settlement were approved. . . ." Pet. App. 8a (quoting Bankr. Ct. opinion). Second, it found that Petitioners "omission from the settlement distribution would not prejudice them." *Id.* This is "because their claims against the Jevic estate were 'effectively worthless' since the estate lacked any unencumbered funds," essential to prosecute the estate's highly speculative fraudulent transfer claims against the secured creditors. *Id.* (quoting Bankr. Ct. opinion).

Moreover, the courts below realistically recognized that there were substantial questions over causation and valuation in claims arising from the Debtor's leveraged buyout, and that the estate had no funds to shoulder the enormous costs for expert trial testimony and a host of other litigation costs, apart from legal fees, to go forward with litigating its claims and defeating the asserted substantive defenses and counterclaims. *Id.* at 9a. In that regard, see *In re Exide Techs.*, 303 B.R. 48, 70 (Bankr. D. Del. 2003) (hereinafter, "*Exide*") ("There is no doubt that [fraudulent transfer] litigation involves complex issues on a variety of topics that will require costly and time-consuming discovery in addition to a potentially lengthy trial, possibly delaying the Debtor's exit from chapter 11."); *In re Chemtura Corp.*, 439 B.R. 561, 607

(Bankr. S.D.N.Y. 2010) ("[T]he legal issues by themselves are many and complex . . . Dealing with them would be expensive and time-consuming."); *In re Lids Corp.*, 281 B.R. 535, 540 (Bankr. D. Del. 2002) (Litigating the worth of a business enterprise requires using multiple complex valuation methodologies in testimony by financial experts).

The courts below thus properly applied the fundamental principle that there can be no recovery for the violation of a right in the absence of injury. They denied relief because Petitioners' claimed harm was based on nothing more than their wishful thinking that blocking the settlement and converting to chapter 7 might have produced some recovery for them. Their position, however, was unsubstantiated at the hearing before the Bankruptcy Court, at which they chose not to offer any evidence of value for the estate's fraudulent transfer claims, despite Respondents' showing that those claims were of dubious, if any, value. There was simply no basis in evaluating those claims at the hearing on settlement for the Bankruptcy Court to find that Petitioners' speculation and hope could have "any legitimate effect upon the valuation." *Powelson,* 319 U.S. at 276.

The Bankruptcy Court correctly approved the settlement on the basis, among others, that Petitioners were not injured by the approval of the settlement.

C. Origin of the requirement of injury

Injury is not a recent requirement of the law. For centuries, injury was a critical feature of early common law, which required a lawsuit to be commenced by means of an established form of complaint, which required an allegation of actual injury to the plaintiff. See Benjamin Shipman, *Handbook of Common-Law Pleading* sections 7, 77 (3d ed. 1923). See also William Blackstone, 3 *Commentaries on the Law of England* 117 (1765–1769); Edward P. Weeks, *The Doctrine of Damnum Absque Injuria Considered in Relation to the Law of Torts* ix (1879) (hereinafter, "Weeks") (premising the requirement of injury on the right of a person to be secure in his life, liberty, health, reputation, and real and personal property). Under that doctrine, a person cannot maintain an action for a wrongful act unless he has sustained an injury. *Id.*

Although the common law forms of pleading have long since been superseded by the modern, less stringent requirements for pleadings in a case, injury remains an essential ingredient of *every* type of right to recover for a violation of a right and of every claim for relief. It is a fundamental requirement without which relief is not available. There is no theoretical or statutory basis to disregard the requirement of injury.

D. Injury continues to be required across the law as a basis for providing relief

Current jurisprudence continues to include injury as a requisite for maintaining a cause of action or for obtaining relief for the violation of a right. Under modern practice, the fundamental requirement of injury is a mandatory element of every type of cause of action if relief is to be available. As a consequence, a violation of the priority rule does not result in the grant of an award in the absence of injury to the objectant. Illustrations of this requirement can be found across the law, including constitutional law, criminal law, tort law and contract law, among all others.

1. Constitutional law

Despite the high level of importance of constitutional rights, a violation of such rights is not actionable if the plaintiff has not incurred injury or prejudice as a result of the violation. As uniformly held by Courts of Appeals, a violation of a constitutional right is not actionable if the plaintiff has not been injured by the violation. See *Perry v. Blum,* 629 F.3d 1, 17 (1st Cir. 2010); *Rapp v. U.S. Dep't of Treasury, Office of Thrift Supervision*, 52 F.3d 1510, 1520 (10th Cir. 1995); *Brock v. Dow Chemical U.S.A.*, 801 F.2d 926, 930–31 (7th Cir. 1986); *Savina Home Indus., Inc. v. Sec'y of Labor*, 594 F.2d 1358, 1365 (10th Cir. 1979); *In re Parcel Consultants, Inc.*, 8 F. App'x 946, 951 (3d Cir. 2003). Thus, even a right as important as due process of law is not actionable in the absence of injury to the complainant. The right asserted by Petitioners on the basis of the priority rule has no greater value than the right to due process. Thus, without a cognizable injury to Petitioners resulting from the settlement, they are not entitled to relief from the settlement by way of vacating the approval of the settlement and a conversion to chapter 7, or requiring the disgorgement of the distributions received years ago by over 1,000 creditors for redistribution under the priority rule, or otherwise.

2. Criminal Law

It is similarly fundamental to American criminal law that criminal prosecutions be conducted with constitutionally afforded protections for the accused. See *Miranda v. Arizona*, 384 U.S. 436, 479 (1966); *Mapp v. Ohio*, 367 U.S. 643, 655 (1961); *Strickland v. Washington*, 466 U.S. 668, 684 (1984). Nevertheless, despite the importance of personal rights afforded a defendant in a criminal prosecution, a conviction is not reversed where the violation of a right is found not to have been prejudicial to the defendant under the so-called "harmless error" rule. *Strickland*, 466 U.S. at 711; see also *Roe v. Flores-Ortega*, 528 U.S. 470, 481 (2000); *Brecht v. Abrahamson,* 507 U.S. 619, 639 (1993) (Court denying habeas relief where error that occurred at trial did not substantially influence the jury's verdict). Indeed, as the Court observed, all 50 States as well as Congress have established harmless-error rules. *Chapman v. California*, 386 U.S. 18, 22 (1967). There is surely no greater reason to adopt a "harmless error" rule to enable a claimant to recover in a civil case in the absence of any cognizable injury than there was in the criminal law.

3. Tort and Contract Law

The requirement of injury is a central element in the law of torts. Two of the first treatises on tort law explained that a plaintiff must have suffered some "injury" or "damage" to recover on a claim. See 1 *Francis Hillard, The Law of Torts or Private Wrong*s 83-84 (2d ed. 1861); see also 1 C.G. Addison, Wrongs and Their Remedies: *A Treatise on the Law of Torts* 2 (4th English ed., F.S.P. Wolferstan ed. 1876). A leading treatise writer also makes clear that injury to the plaintiff is an essential ingredient of a tort cause of action. See

William L. Prosser, *Handbook of the Law of Torts* 8-9 (1941); see also, *Restatement of Torts* §1 cmt. d (1934)).

The underpinning of the injury requirement was explained in Edward P. Weeks' leading treatise. See Weeks, *supra* at ix. That scholar observes that early tort common law was premised on the notion that a person has a right to be secure in his life, liberty, health, reputation, and real and personal property, noting that the doctrine, *damnum absque injuria,* literally means damage without injury. *Id.* To constitute a tort, there must be "actual or legal damage to the plaintiff, and a wrongful act committed by the defendant." *Id.* at 2 (citations omitted).

Just as in tort law, injury must be established to recover damages in an action for breach of contract. See 24 *Williston on Contracts* § 64.8 (4th ed.); see also, *CQ, Inc. v. TXU Min. Co., L.P.*, 565 F.3d at 278.

The Circuit Court below was correct in relying on the absence of injury or prejudice to Petitioners in holding that the Bankruptcy Court properly approved the settlement without its inclusion of Petitioners. The decision below should be affirmed because of the lack of injury to Petitioners, making it unnecessary for the Court to address whether the priority rule is a *per se* pronouncement that does not allow any exceptions.

POINT II

THE PRIORITY RULE IS NOT ABSOLUTE AND MANY TYPES OF DEPARTURES ARE RECOGNIZED

A. The Absolute Priority Rule was Not "Absolute" Even When it Was Given Its Name

The term "absolute priority rule" seems to have originated with Mr. Justice Douglas in *Los Angeles Lumber*, 308 U.S. at 117. That case presented the question "of the conditions under which stockholders may participate in a plan of reorganization under s 77B . . . of the Bankruptcy Act where the debtor corporation is insolvent. . . ." *Id.* at 108–09. Observing that the words "fair and equitable" in section 77B(f) were "terms of art," he noted that such term of art had acquired "a fixed meaning" including the prohibition in *Northern Pacific Railway Co. v. Boyd,* 228 U.S. 482 (1913), against old shareholders retaining value under reorganization plan at the expense of creditors. *Los Angeles Lumber*, 308 U.S. at 115. Justice Douglas called this the "rule of full or absolute priority." *Id.* at 117. The use of the word "absolute", while catching, is, unfortunately overbroad and therefore inapt. In the first place, the Court in *Los Angeles Lumber* was not addressing inter-creditor priorities, such as those involved in the case at bar.

Secondly, even at the time *Los Angeles Lumber* was decided, this Court had contemplated the propriety of shareholders being "permitted to contribute and retain an interest [in the reorganized entity] sufficiently valuable to move them [to provide funding].” *Kansas City Terminal Ry v. Cent Union Trust Co.,* 271 U.S. 445, 455 (1926). Hence, calling the rule “absolute” overstated its reach even in the context of priorities between creditors and equity holders. See generally, Lubben, “The Overstated Absolute Priority Rule,” 21 Fordham J. Corp. & Fin. L. 581 (2016); Bruce Grohsgal *How Absolute Is the Absolute Priority Rule in Bankruptcy? The Case for Structured Dismissals* (September 29, 2016), William & Mary Bus. L. Rev. (forthcoming 2017); (manuscript at 25-30), *available at* http://ssrn.com/abstract=2845430 (hereinafter, “Grohsgal”). The reality is that the phrase “absolute priority rule” is a misnomer; the rule is not absolute and there are many well-established and fully sanctioned departures from it, as later discussed herein.

B. Absolute Rules Invite Injustice

Insofar as the priority rule is not absolute, it should be unnecessary to point out that absolute, rigid and unyielding rules are disfavored in our jurisprudence. Nonetheless, Petitioners’ urging to apply the priority rule rigidly makes that necessary to point out.

Civilized systems of justice, harkening back to Aristotle, have recognized that hard and fast rules lead to injustice because of the inability to foresee every circumstance that could arise in the future. As explained by Paul Vinogradoff, the Corpus Professor of Jurisprudence in the University at Oxford:

> [L]egal rules are necessarily general, while the circumstances of every case are particular, and that it is beyond the power of human insight and science to lay down

> in advance rules which will fit all future variations and complications of practice. Therefore law must be supplemented by equity (epieikeia); there must be a power of adaptation and flexible treatment, sometimes suggesting decisions which will be at variance with formally recognized law, and yet will turn out to be intrinsically just.

Paul Vinogradoff, *Common Sense in Law* 209 (The Lawbook Exchange, Ltd. 2006, originally published in 1914); see also, Randolph Haines, *Eleventh Circuit Distorts Equity With Formalism*, 2016 No. 4 Norton Bankr. L. Advisor 1, 6 (2016) (citing Aristotle, *Nicomachean Ethics Book V*, Ch. 10 (W.D. Ross Trans. 1925).

This Court has been wary of absolute rules, even when dealing with something as sacrosanct as the Constitution. Nearly a century has passed since Justice Holmes in *Bain Peanut Co. v. Pinson* astutely observed that "[t]he interpretation of constitutional principles must not be too literal" and "[w]e must remember that the machinery of government would not work if it were not allowed a little play in its joints." 282 U.S. 499, 501 (1930). An inflexible and rigid approach may unwisely thwart both the administration of justice and the need properly to address unforeseen circumstances. See also *Reynolds v. Sims*, 377 U.S. 533, 577–78 (1964); *Walz v. Tax Comm'n. of N.Y.*, 397 U.S. 664, 669 (1970) ("there is room for play in the joints. . . ."); *Hamling v. United States*, 418 U.S. 87, 138 (1974) (same); Cf. *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 132 S. Ct. 2065, 2070 (2012) (Court admonishing hyperliteral application of statute contrary to common sense); see also *Nelson v. Scala*, 192 F.3d 32, 35 (1st Cir. 1999); *Miller v.*

Okmi Sul (*In re Miller*), 299 F.3d 183, 186–87 (3d Cir. 2002); *Lehman v. VisionSpan*, *Inc. (In re Lehman)*, 205 F.3d 1255, 1257 (11th Cir. 2000).

In sum, this Court's jurisprudence against absolutism stands as a general barrier to the absolutism urged by Petitioners and their *amici* in this case.

C. There Are Many Approved Departures from the Priority Rule

There are many well-known and accepted departures from the Rule, which are discussed below. *Amici* suggest, and the discussion below shows, that the unifying theme (or explanation) of these departures is benefit to the estate, which, together with the absence of harm to the objectants, is precisely the rationale that led the Courts below to approve the instant settlement.

1. Substantive Consolidation is an Accepted Departure From the Priority Rule

The doctrine of substantive consolidation is one exception. Substantive consolidation allows courts to disregard the separateness of entities and thereby pool their assets and claims together as if they were a single entity from which the collective creditor body may recover. 2 *Collier on Bankruptcy*, ¶ 105.09 (16th ed. 2016). Substantive consolidation is a judicially created equitable doctrine without explicit authorization in the Bankruptcy Code. See *In re Auto-Train Corp., Inc.*, 810 F.2d 270, 276 (D.C. Cir. 1987); *Eastgroup Props. v. S. Motel Ass'n, Ltd.*, 935 F.2d 245, 248 (11th Cir. 1991); *In re Augie/Restivo Baking Co., Ltd.,* 860 F.2d 515, 518 (2d Cir. 1988).

Substantive consolidation ordinarily alters distributional priorities because, as elaborated by the Circuit Court for the District of Columbia in *Auto-Train*, "every entity is likely to have a different debt-to-asset ratio, consolidation almost invariably redistributes wealth among the creditors of the various entities." *In re Auto-Train Corp., Inc.*, 810 F.2d at 276. Notwithstanding this prejudice suffered by some creditors, "[n]o court has held that substantive consolidation is not authorized." *In re Owens Corning*, 419 F.3d 195, 208 (3d Cir. 2005). Rather, substantive consolidation is required under "rare" and "justified" facts. See *e.g.*, *Chemical Bank New York Trust Co. v. Kheel*, 369 F.2d 845, 846–47 (2d Cir. 1966) (hereinafter, "*Chemical Bank*").

The *Chemical Bank* case also explicitly recognized that, in a proper case, benefit to the estate is the dominant priority.

> [I]n the rare case such as this, where the interrelationships of the group are hopelessly obscured and the time and expense necessary even to attempt to unscramble them [is] *so substantial as to threaten the realization of any net assets for all the creditors, equity is not helpless to reach a rough approximation of justice to some rather than deny any to all.*

Id. at 847 (emphasis added). In short, substantive consolidation is a recognized exception to the Rule where, as in this case, circumstances present a choice between justice for some or justice for none. As eloquently stated in *Chemical Bank*, "equity is not helpless to reach a rough approximation of justice to some rather than deny any to all." *Id.*

Accordingly, the Bankruptcy Court in this case properly approved a settlement conferring justice on some, rather than disapproving the settlement and denying justice for all.

2. Critical Vendor Orders Are an Accepted Departure from the Rule

Critical vendor orders are another compelling example of where courts set aside the Code's priority scheme in order to benefit the bankruptcy estate by enabling a reorganizing debtor to obtain goods and services critical to its survival and prospects of repaying debt. A critical vendor order permits certain pre-petition creditors to be paid out of priority as administrative claims to help the debtor's business continue and provide a better chance (but not a guaranty) of recovery for the creditor body as a whole. See generally, *In re Lehigh & New England Railway Co.*, 657 F.2d 570, 581 (3d Cir. 1981). *Amici* note that critical vendor orders really are an exception to the Rule, contrary to what is asserted in *Brief for Amici Curiae Law Professors in Support of Petitioners* at 13, n.12. In fact, critical vendor payments are final and not subject to disgorgement, thus irrevocably re-arranging priorities. *In re Meridian Auto Sys.-Composites Operations, Inc. (In re Meridian)*, 372 B.R. 710 (Bankr. D. Del. 2007).

Admittedly, critical vendor orders are not universally accepted. See, e.g., *Official Committee of Equity Security Holders v. Mabey*, 832 F.2d 299 (4th Cir. 1987); *In re B&W Enters., Inc.,* 713 F.2d 534 (9th Cir. 1983); *In re Oxford Mgmt., Inc.*, 4 F.3d 1329 (5th Cir. 1993); and see *In re K-Mart Corp.*, 359 F.3d 866 (7th Cir. 2004) (restricting, but not banning such orders). That being said, such orders are particularly accepted in the Second and Third Circuits in which many of the largest and most significant chapter 11 cases are filed. *Lehigh*, 657 F.2d at 581; *In re Ionosphere Clubs, Inc.*, 98 B.R. 174, 175 (Bankr. S.D., 1989). Quite remarkably, a recent survey of large chapter 11 cases found that *not one* motion for a critical vendor was denied. See, Elizabeth Shumejda, *Critical Vendor Trade Agreements in Chapter 11 Bankruptcy*, 24 Am. Bankr. Inst. L. Rev. at 161 (2016). In short, critical vendor orders are far more accepted and commonplace than they might appear to be just based on tabulating the ostensible split in authorities. Accordingly, such orders stand as a meaningful accepted exception to the priority rule.

3. Cross-Collateralization is an Accepted Departure From the Rule

Cross-collateralization is yet another compelling example of courts setting aside the Code's priority scheme when necessary to benefit the estate. Cross-collateralization is a process by which a debtor-in-possession ("DIP") grants a lien on post-petition collateral to secure pre-petition unsecured debt in order to obtain post-petition financing. See generally, Jennifer J. Rickert, *Cross Collateralization: An Appropriate Method of Section 364 Post-Petition Financing*, 66 Temp. L. Rev. 239, 239–40 (1993). Cross-collateralization departs from the Code's priority scheme because it "empowers an undersecured creditor-lender to claim a greater portion of a business' assets than it would ordinarily receive under the repayment rules established in the statutory text of the Bankruptcy Code." Craig R. Bucki, *Cracking the Code: The Legal Authority Behind Extrastatutory Debtor-In-Possession Financing Mechanisms and*

Their Prospects for Survival, 2005 Colum. Bus. L. Rev. 357, 361 (2005).

Yet, courts outside the Eleventh Circuit routinely uphold cross-collateralization to give the DIP necessary financing to run the business. *In re Adams Apple*, 829 F.2d 1484 (9th Cir. 1987); *In re Ellingsen MacLean Oil Co.*, 834 F.2d 599 (6th Cir. 1987); *In re Texlon Corp.*, 596 F.2d 1092 (2d Cir. 1979) (leading case); *In re Vanguard Diversified, Inc.*, 31 B.R. 364 (Bankr. E.D.N.Y. 1983); *In re Tower Air*, 397 F.3d 191 (3d Cir. 2005). But see, *Shapiro v. Saybrook Mfg. Co. (In re Saybrook Mfg. Co.)*, 963 F.2d 1494 (11th Cir. 1992) (holding that cross-collateralization is inconsistent with the Code).

In sum, here again, a majority of courts depart from the Rule in dire circumstances. Cross-collateralization is permitted when without it, there would be no DIP financing, and the reorganization would be doomed. Accordingly, in approving the settlement below, the Bankruptcy Court properly departed from the Rule in order to avoid dooming all creditors in this case to no recovery.

D. Settlements May Deviate from the Rule

Courts have not only recognized departures from the Rule in the contexts of substantive consolidation, critical vendor orders and cross-collateralization, but also leave room for such departures in the context of settlements as well.

1. This Court's Decision in *TMT Trailer* does not Prevent Any and All Departures from the Rule in Settlements.

In *TMT Trailer*, 390 U.S. 414, this Court considered a settlement that had been effectuated in the context of a plan of reorganization under

Chapter X of the former Bankruptcy Act. The case, properly understood, presented two distinct issues: first, the standard for approving a settlement *vel non*; second, the standard for confirming a Chapter X plan.

As to the first issue, the Court noted that a settlement must be "fair and equitable" and that the court in deciding whether to approve a settlement must make an "informed and independent judgment" which requires that the judge "has apprised himself of all facts necessary for an intelligent and objective opinion of the probabilities of ultimate success should the claim be litigated." *Id.* at 424. This Court found, however, that the record below in *TMT Trailer* left the Court "completely uninformed as to whether the trial court ever evaluated the merits" and that "the record is devoid of facts which would have permitted a reasoned judgment that the claims of actions should be settled in this fashion." *Id.* at 440–41. These inadequacies were among the reasons leading the Court to remand the case for "further investigation." *Id.* at 441.

Separately, this Court in *TMT Trailer* considered plan confirmation requirements under the now statutorily superseded provisions of Chapter X, former 11 U.S.C. §501, *et seq.* On that issue, this Court noted the fair and equitable standard *needed to confirm a chapter X plan* "incorporates the absolute priority doctrine." *Id.* (emphasis added). Nowhere, however, does the *TMT Trailer* opinion instruct that the so-called absolute priority rule applies to settlements, *except* as incorporated in a Chapter X plan. See Grohsgal at 42–46. Certainly *TMT Trailer* could not have addressed the instant settlement, which took place under the current Code but not under a plan. Indeed, the current Code, for its part, confines the statutory application of the priority rule to chapter 11 plans, 11 U.S.C. §1129(b)(2)(B)(ii) (2012) and to distributions in a chapter 7 case, 11 U.S.C. §726(a) (2012).

Therefore, the Circuit Court below got it right in recognizing that *TMT Trailer* is "not dispositive because [it] spoke in the context of plans of reorganization, not settlements." Pet. App. 17a. And, the Circuit Court also got it right because it had an ample record, *unlike* the lower court in *TMT Trailer*.

2. *Iridium* is a Well Reasoned Case Allowing the Possibility that a Settlement May Depart from the Rule.

(a) The priority rule is not a per se ban under *Iridium*.

In *Iridium*, 478 F.3d at 455, the Second Circuit endorsed the possibility of departure from the priority rule in an appropriate settlement. Iridium was an ill-fated satellite venture that had been launched, but later spun off, by Motorola. *Id.* at 456. In the months preceding its collapse, Iridium executed a series of credit facilities with its senior lenders providing for $1.55 billion in loans secured by first priority liens on all of Iridium's property, including causes of action against Motorola. *Id.* at 457. The unsecured creditors' committee, given its limited financial resources, opted to settle the avoidance claims with senior lenders in order to receive funds in which to pursue their own claims against Motorola. *Id.* Although a large portion of any monies recovered from Motorola as a result of the Motorola Estate Action would likely flow to the Estate and be distributed according to the Bankruptcy Code's priority scheme, *id.* at 459, nevertheless, the litigation trust provided for payment to unsecured creditors of residual funds from the litigation trust *before* full recovery of some priority creditors, including Motorola. *Id.*

The Second Circuit rejected the *per se* ban on settlements violating the priority rule as "too rigid a test" because such a rigid test was unable to "accommodate the dynamic status of some . . . settlements." *Id.* at 464. The Court explained "[i]t is difficult to employ the rule of priorities in the approval of a settlement in a case such as this when the nature and extent of the Estate and the claims against it are not yet fully resolved." *Id.*

(b) A remand is the proper course if the Court considers the record to be inadequate

Since the record in *Iridium* provided no justification for departing from the Rule in that particular settlement, the Second Circuit in *Iridium*, as in *TMT Trailer*, remanded the case for further development of the record. *Id.* at 467. The court in *Iridium* stated "[o]ur remand is not a repudiation of that support—it seeks only clarification of why the settlement need require a possible deviation from the rule in one regard." *Id.* at 466.

Although some cases, such as *Matter of AWECO, Inc.,* 725 F.2d 293 (5th Cir. 1984), have applied a *per se* approach, *Iridium's* careful methodology is the better path. Because the central facts warranting approval of settlement in this case are uncontested, *Amici* submit the record here (unlike that in *TMT Trailer* and *Iridium*) supports affirmance. If this Court does not share that view, however, *Amici* respectfully submit that the proper course is a remand, as in both *TMT Trailer* and *Iridium*.

E. Congress Made Exceptions to the Rule

The cases just discussed show that the so-called "absolute" priority rule is not absolute because the courts have found numerous circumstances where departure is appropriate and allowable: substantive consolidation, cross-collateralization, critical vendor orders and settlements. Still, it is not just courts that have made the Rule *not* absolute, but Congress as well. The term "absolute priority rule" appears nowhere in the Code.

Further, the Code itself contains a number of statutory exceptions to the rule: these include contract and lease assumptions where pre-petition defaults must be cured as administrative expenses, 11 U.S.C. § 365 (2012), and reclamation claims, 11 U.S.C. § 546 (2012).[3] The point here is not that there exists some express statutory exception authorizing the settlement in the instant case (although we are quick to note there

[3] Intriguingly, as Prof. Grohsgal shows, Congressional action since *Los Angeles Lumber* has consistently contracted, or rolled back, the priority rule. *See* Grohsgal at 25-30, discussing the 1952 amendments to the Bankruptcy Act, the enactment of 1978 Code allowing consensual plans to depart from the rule, and the 1986 and 2005 legislative roll backs of the priority rule as applied to certain family business. Of course, *Amici* do not argue that these contractions create an express statutory exception to approve the present settlement. The point, rather, is to further illustrate how unabsolute the priority rule really is.

is no express prohibition either); rather, the point is that the rule is *not* absolute, it yields statutorily in some instances and judicially in other instances where benefit to the estate is properly a dominant concern.

POINT III

THE FINDINGS BELOW WERE BASED ON A THOROUGH RECORD, HAVE BEEN CONCEDED, AND WERE MORE THAN SUFFICIENT TO APPROVE THE SETTLEMENT

The Bankruptcy Court in the present case received proffered testimony of Mr. Daniel Dooley, the Debtors' Chief Restructuring Officer, J.A. 205 (Hearing Transcript), and of the Creditors' Committee financial advisor, Mr. Edward Gavin, *id.* at 229. Both testified in support of the settlement. No adverse witness testimony was offered by proffer or otherwise. On cross-examination of Mr. Dooley, Petitioners' attorney chose not to address the merits of the fraudulent transfer claims against the secured creditors, which were being released under the settlement. See generally *id.* at 211–26.

Supplementing the testimony of Mr. Dooley, the proffered testimony in support of the settlement of Mr. Gavin focused specifically on the fraudulent transfer claims asserted against the secured creditors that arose out of the debtor's pre-bankruptcy leveraged buyout ("LBO"). He gave uncontroverted proferred testimony that the expert testimony that would be offered at trial would establish that the LBO in 2006, two years before the debtor's chapter 11 filing in 2008 "was not the cause of the company's failure," J.A. 232, but the failure was predicated on intervening events that occurred after the LBO, "such as the declining economy and the shrinking demand for the trucking kind of business that Jevic was in," *id.*, thereby undermining the important predicate of causation of insolvency for winning fraudulent conveyance litigation. See 11 U.S.C. § 548(a)(1)(B)(ii). Mr. Gavin also testified that these facts "would be serious challenges" to proving that the debtor was insolvent at the time of the LBO, *id.* at 232–33, thereby undermining another predicate for success. Mr. Gavin also testified that such litigation would be very complex and costly through trial and appellate stages, and that counsel for the plaintiff would have to advance the costs personally because the estate lacked the funds to pay them. *Id.* at 233–36, 243. Mr. Dooley, apart from Mr. Gavin, suggested the costs of litigation were multi-million dollar costs, with no identified source to pay for expert witnesses saying, "[w]ho is going to pay for those?" *Id.* at 225. Mr. Gavin further testified that approval of the settlement was the wiser course because of the "substantial uncertainty in the further prosecution of the lawsuit. . . ." *Id.* at 235. Lastly, the settlement deal itself would not have been available in a chapter 7 case. The testimony offered through these witnesses was uncontroverted.

On the foregoing record, the Bankruptcy Court had a solid basis for concluding that the settlement should be approved. That court got it dead right that the choice was between meaningful recovery or zero, and it correctly chose meaningful recovery.

In upholding the Bankruptcy Court's approval of the settlement, the Circuit Court pointed out that the Petitioners "mount no real challenge to the Bankruptcy Court's findings that there was no prospect of a confirmable plan in this case and that conversion to Chapter 7 was a bridge to nowhere." Pet. App. 14–15a (citing Bankr. Ct. opinion). Significantly, the District Court, in affirming the decision of the Bankruptcy Court, observed that Petitioners "largely do not contest the bankruptcy court's factual findings." *Id.* at 40a. Crucially, the Third Circuit noted that "even if it were appropriate for us to review findings of fact de novo," there was "no evidence" that questioned the Bankruptcy Court's conclusion that approval of the settlement offered the only basis for making a distribution to unsecured creditors. *Id.* at 21a. Nor was there anything in the record to contradict the finding that the fraudulent transfer claims "were 'effectively worthless.'" *Id.* at 8a (3rd Cir. opinion quoting Bankr. Ct. opinion). Finally, there is no claim that the applicable standard for approving a settlement set forth in *In re Martin, supra*, 91 F.3d 389, was not met.

Bluntly, where the factual predicates are established by competent testimony and are uncontradicted, and where the applicable legal standard for approving the motion has concededly been met, the settlement should be upheld. It is elemental that absent a clearly erroneous finding of fact or an error of law the approval of a settlement should be upheld. See *United States v. U.S. Gypsum Co.*, 333 U.S. 364, 395, (1948) (this Court may reverse findings of fact by a trial court where 'clearly erroneous'); see also *id.* ("A finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed.").

POINT IV

THE DEPARTURE FROM THE PRIORITY RULE WAS APPROPRIATE BECAUSE REJECTION OF THE SETTLEMENT AND CONVERSION TO CHAPTER 7 WOULD HAVE HARMED THE ESTATE WITHOUT HELPING PETITIONERS

In the present case, the estate's assets were fully encumbered. Pet. App. 8a (3rd Cir. opinion citing Bankr. Ct. opinion). Conversion to chapter 7 would have been of no avail to Petitioners even if the fraudulent transfer claims were successful, because the secured lenders' liens would have denuded the estate in short order. *Id.* The settlement approved in this case provides wider recovery for the large creditor body than would application of the Rule or conversion to chapter 7. See *id.* at 57–58a (Bankr. Ct. opinion). Here, not only would reversing the decision below not provide a recovery for Petitioners, it would actually result in injury to the estate and over 1,000 general unsecured creditors. Unrebutted testimony at the settlement hearing established that the fraudulent conveyance litigation would cost millions of dollars to bring the case to trial. J.A. 234 (Hearing Transcript). Indeed, the Bankruptcy Court specifically opined that any lawyer that would take this litigation on a contingency fee basis "should have his head examined." Pet. App. 61a (Bankr. Ct. opinion). *Cf*, *Exide,* 303 B.R. at 70.

Moreover, if the case were converted to chapter 7, the recovery that was afforded to the general unsecured creditors through the settlement would not have been effectuated. The secured creditors "stated unequivocally and credibly that they would not do this deal in a Chapter 7." Pet. App. 8a (3d Cir. quoting Bankr. Ct. opinion).

Further, the Bankruptcy Court specifically found that there was "no realistic prospect" of a meaningful distribution to anyone but the secured creditors unless the settlement were approved.

> [B]ecause the traditional routes out of Chapter 11 bankruptcy were impracticable . . . there was "no prospect" of a confirmable Chapter 11 plan of reorganization or liquidation being filed. . . . [C]onversion to liquidation under Chapter 7 of the Bankruptcy Code would have been unavailing for any party because a Chapter 7 trustee would not have had sufficient funds "to operate, investigate or litigate" (since all the cash left in the estate was encumbered) and the secured creditors had "stated unequivocally and credibly that they would not do this deal in a Chapter 7."

Id. (citation omitted). The Bankruptcy Court also found that the claims against the Jevic estate were "effectively worthless" since the estate lacked any unencumbered funds. *Id.* at 61a (Bankr. Ct. opinion).

The Petitioners largely "[did] not contest the bankruptcy court's factual findings" at the District Court, *id.* at 40a, and the Third Circuit declined to question them on appeal. *Id.* at 21a. Left with undisturbed factual findings that conclusively establish that Petitioner's inability to recover remains the same regardless of the application of the Rule, this appeal both has and will only produce increased costs and harm to the estate and its large body of general unsecured creditors. Conversion to a chapter 7 would result in no payment to creditors other than the secured creditors because they would not have released the lien on the $1.7 million and would not have agreed to provide the $2 million cash infusion for the benefit of the estate.

The only reason there is any recovery available under chapter 11 is because the secured lenders are providing a net gain of $3.7 million to the estate. The relief requested by Petitioners would eliminate this net gain, leaving the estate with no unencumbered assets, thus foreclosing its ability to pursue the costly fraudulent conveyance litigation. Therefore, the relief requested by Petitioners is a "bridge to nowhere." *Id.* at 15a (3d Cir. quoting Bankr. Ct. opinion).

CONCLUSION

Based on the foregoing, and Respondents' brief, it is respectfully requested that the Third Circuit's decision be affirmed. Alternatively, if the Court concludes that further development of the record is warranted, it is respectfully urged that the Court order a remand for consideration of why Petitioners were not included in the settlement and whether there was any means for them to realize a recovery in the bankruptcy.

Respectfully submitted,

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