

Chapman Client Alert

February 7, 2018

Current Issues Relevant to Our Clients

First Circuit's *Old Cold* Decision Cools Fears of Expanded Scope of *Jevic*'s Reach; Declines to Apply *Jevic* to Disturb Assumption of Liabilities in 363 Sale that may have Violated Absolute Priority Rule

The Supreme Court's March 2017 decision in *Czyzewski v. Jevic Holding Corporation*¹, which held that structured dismissals must follow the same absolute priority rules as plans of reorganization, made some court-watchers nervous that the decision would be applied broadly to disturb other bankruptcy-related distributions. Some feared that distributions under so-called gift plans and in connection with asset sales could be prohibited, notwithstanding the *Jevic* Court's attempt to distinguish distributions made in connection with structured dismissals from other types of distributions.

In the latest attempt to further expand the application of *Jevic*, the losing bidder in a 363 sale argued that the winning bidder's assumption of certain lower ranked liabilities and not other higher ranked liabilities (a common feature of 363 sales) violated the absolute priority rule and should not be approved under *Jevic*. The United States Court of Appeals for the First Circuit, in *In re Old Cold LLC*², affirmed the bankruptcy court's authorization of the debtor's sale of substantially all of its assets and expressly declined to apply *Jevic* to disturb the sale, notwithstanding an alleged sale-related absolute priority violation.

The First Circuit's *Old Cold* decision follows a decision from the Delaware district court in *In re Nuverra Envtl. Sols., Inc.*³, in which the court failed to apply *Jevic* to disturb distributions under a so-called gift plan. These decisions suggest that courts are thus far willing to contain the impact of *Jevic* to its particular facts.

Background

In March of 2017, the Supreme Court addressed the permissibility under the Bankruptcy Code of a proposed settlement of claims in connection with the structured dismissal of a bankruptcy case contemplating distributions contrary to the absolute priority rule. In *Jevic*, the Supreme Court held, in a 6-2 decision, that "[a] distribution scheme ordered in connection with the dismissal of a chapter 11 case cannot, without the consent of the parties, deviate from the basic priority rules that apply under the primary mechanisms the Code establishes for final distribution of estate value in business bankruptcies."⁴

The Court's opinion was drafted narrowly to apply only in cases of structured dismissals following chapter 11 filings. Distributions that would violate the statutory priority scheme in other circumstances that might arise in connection with chapter 11 cases, including, for example, settlements of claims during the pendency of a chapter 11 case or payments

under so-called 'first day' motions commonly filed at the start of chapter 11 cases that seek authority to make distributions to critical vendors, wage claimants, and others, were excluded from the Court's ruling. The Court also expressly disclaimed making any findings as to the legality of structured dismissals, generally.

In distinguishing the facts at issue in *Jevic* from commonly allowed deviations from the statutory absolute priority scheme in what the Court termed 'interim distributions' (*i.e.*, settlements and first day relief), the Court emphasized the nature of a structured dismissal as a 'final disposition' (along with plan confirmation and conversion of a case to a liquidation under chapter 7), rather than a case milestone or interim distribution. The Court did not make clear, however, what constituted the universe of 'interim distributions' or express any opinion on the decision's impact on asset sales or gift plans.

The First Circuit Expressly Limits the Reach of *Jevic*

On January 12, 2018, the First Circuit published an opinion in *Old Cold* affirming the bankruptcy court's authorization of a chapter 11 debtor's sale of substantially all of its assets, holding, among other things, that section 363(m) of the Bankruptcy Code, which protects 'good faith' purchasers of a debtor's assets, applies regardless of whether or not an absolute priority violation occurred as a result of the sale.⁵

In *Old Cold*, debtor Tempnology, LLC sold its assets pursuant to section 363 of the Bankruptcy Code to Schleicher and Stebbins Hotels LLC ("S & S") following a competitive auction. The runner-up bidder, Mission Product Holdings, Inc., appealed from the bankruptcy court's order approving the sale to S & S and sought to be declared the winning bidder. The First Circuit affirmed the bankruptcy court's sale order without reaching the merits of Mission's challenges to the sale because it found that the sale to S & S had been completed and S & S was a "good faith" purchaser entitled to protection under section 363(m).

In so holding, the First Circuit refused to consider Mission's assertion that the sale, and S & S's agreement to assume approximately \$657,000 of debtor's liabilities in connection with the sale, had violated the absolute priority rule because it provided for the payment of certain unsecured claims before certain administrative claims held by Mission were satisfied.⁶ Notably, in 363 sales, buyers will often assume liabilities that are important for continuation of the debtor's business in the hands of the purchaser, including, for example, liabilities owed to critical vendors. Courts have consistently approved the assumption of such liabilities even though more senior liabilities are not assumed because courts have recognized the important distinction between a buyer deciding which debt needs to be assumed as part of the sale and a debtor applying sale proceeds to its creditors. This ability of asset sale purchasers to assume junior debt (such as important vendors and suppliers) while leaving behind senior debt is an important feature of many 363 sales and any decision that limited such ability could have had a severely negative impact on the utility of 363 sales.

The First Circuit expressly declined to apply *Jevic*, holding that "section 363(m) applies even if the bankruptcy court's approval of the sale was not proper, as long as the bankruptcy court was acting under section 363(b).⁷ Section 363(m) sets forth

only two requirements: that there is a good faith purchaser, and that the sale is unstayed. Nothing in *Jevic* appears to add an exception to this statutory text."⁸ In so holding, the First Circuit rejected the argument that "*Jevic*'s enforcement of priority rules applies to all end-of-case distributions, including asset sales."⁹ In support of its holding, the court noted further that "the [*Jevic*] Court did not call into question the validity of first-day wage orders or critical vendor orders that violate priority rules."¹⁰

Delaware District Court Previously Signaled No Impact from *Jevic* on 'Gift Plans'

This decision follows the prior decision of the Delaware District Court in *In re Nuverra Environmental Solutions, Inc.*, which, on August 3, 2017, as we discussed in a prior client alert,¹¹ upheld the bankruptcy court's confirmation of a so-called "gift plan" (*i.e.*, a plan of reorganization in which a senior creditor class "gifts" a portion of its plan distribution to a junior class), notwithstanding the Supreme Court's holding in *Jevic*, which some commentators predicted might be construed to limit the viability of gifting schemes.¹²

In *Nuverra*, the Delaware bankruptcy court was presented with a plan of reorganization that relied on secured creditors making a gift under the plan to two classes of unsecured creditors who would not otherwise have been entitled to recover anything under the absolute priority rule: (a) holders of unsecured senior notes would receive a four to six percent recovery of their claims based on the gift and (b) trade and other creditors whose claims arose from day-to-day operations would receive a 100 percent recovery. The trade creditors receiving a full recovery voted to accept the proposal, while the unsecured senior noteholders voted to reject and objected to the gift plan as being unfairly discriminatory.

The bankruptcy court overruled the objection, explaining that, because the noteholder class was not entitled to any distribution at all under the absolute priority rule, (*i.e.*, it would have received nothing but for the gift), there was no discrimination — both the noteholders and trade creditors were the beneficiaries of a gift. On appeal, the district court affirmed. Notably, both the bankruptcy court and the district court in *Nuverra* relied on past Delaware gift plan case law, but neither court addressed *Jevic* or indicated that the Supreme Court's ruling would have any impact whatsoever on gift plan law.¹³

Conclusion

The First Circuit's willingness to take the Supreme Court at its word and limit *Jevic* to its specific facts and to distributions in connection with structured dismissals is good news for Debtors and their creditors who appreciate the flexibility of using interim and other non-plan distributions that might otherwise be precluded by the stringent absolute priority rules that apply to distributions under a plan of reorganization or liquidation, or, following *Jevic*, structured dismissals. While other courts may yet apply *Jevic* beyond its facts, recent decisions of the Delaware District Court and the First Circuit suggest that fears of the potential broad impact of *Jevic* may have been exaggerated.

For More Information

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- 1 *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973, 197 L. Ed. 2d 398 (2017).
 - 2 *In re Old Cold LLC*, No. 16-9012, 2018 WL 387619 (1st Cir. Jan. 12, 2018).
 - 3 *In re Nuverra Envtl. Sols., Inc.*, No. 17-10949-KJC, 2017 WL 3326453 (D. Del. Aug. 3, 2017).
 - 4 *Jevic*, 137 S. Ct. at 978.
 - 5 *In re Old Cold LLC*, No. 16-9012, 2018 WL 387619 (1st Cir. Jan. 12, 2018).
 - 6 *Id.* at 10.
 - 7 *Jevic* was not addressed by the Bankruptcy Court. As the First Circuit noted in its opinion, *Jevic* was decided by the Supreme Court over a year after entry of the bankruptcy court's order. *Id.*
 - 8 *Id.* at 11.
 - 9 *Id.* at 10.
 - 10 *Id.* Notably, the First Circuit failed to reach the substantive question of whether *Jevic* might apply, in the first instance, to prevent 363 sales that embody absolute priority violations, and it is possible that future litigants could raise the issue at a point before 363(m) would apply. However, the First Circuit's characterization of *Jevic*'s holding suggests that the court would be skeptical of such an application.
 - 11 More information about gift plans is available in our previous Client Alert available [here](#) and podcast available [here](#).
 - 12 *In re Nuverra Envtl. Sols., Inc.*, No. 17-10949-KJC, 2017 WL 3326453 (D. Del. Aug. 3, 2017).
 - 13 For more on *Nuverra* and gift plans, please see the article referenced in footnote 11.

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