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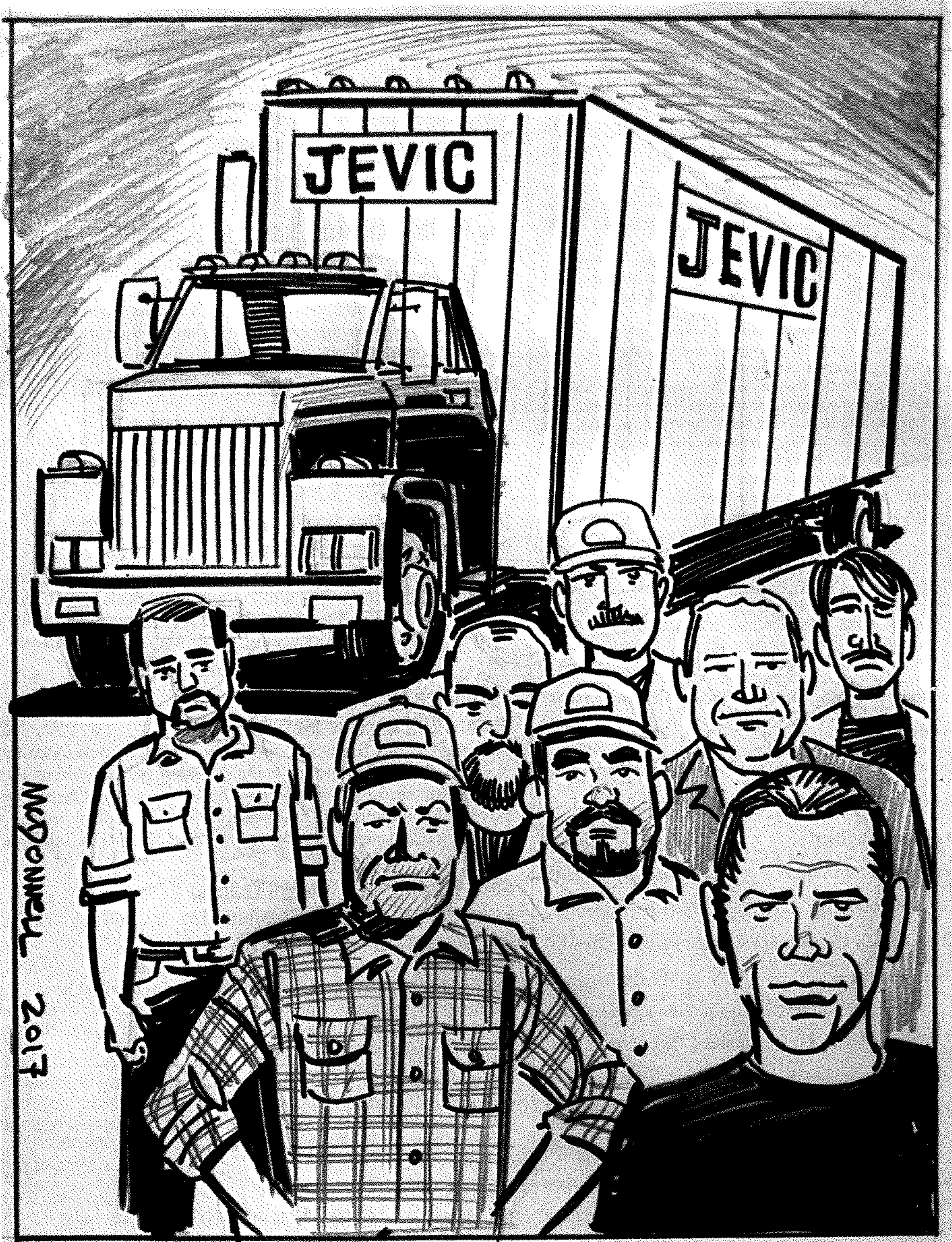

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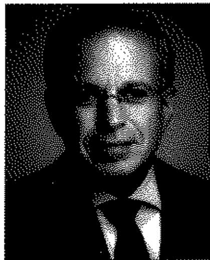
A SUPREME COURT WIN FOR ALL EMPLOYEES

by Jack A. Raisner, Esq.



Two thousand "have-nots" prevailed at the U.S. Supreme Court this past term. They had driven long-haul trucks for a company called Jevic. But they were fired *en masse* nine years ago when Jevic was shut down by powerful financiers who owned it.

Seeking redress for their job loss at the trial level, the truckers came away with something at first. They won a $12 million judgment because they had received no advance notice before being terminated, a violation of New Jersey's WARN Act (Worker Adjustment Retraining and Notification). But collecting that amount was made difficult by Jevic's owners. They had put Jevic in bankruptcy. That made the truckers bankruptcy creditors. Jevic's other creditors would collect some money from the estate. But the owner-financiers singled out the truckers. They demanded the estate not pay the truckers a single penny. That rendered their $12 million legal "victory" against Jevic worthless.

The truckers objected to the bankruptcy court. They asserted one of bankruptcy's most time-honored rules — that back pay wages have a priority and must be paid before other creditors are satisfied. But the financiers won. The truckers appealed. In the district court and the circuit court of appeals, again, the financiers won. By their victories, the financiers effectively wiped away not only the $12 million claim, but the immutable priority principle protecting employees.

When the Supreme Court took their case, the bankruptcy world sat up and held its collective breath. After eight years of litigation, the truckers hoped the eight sitting justices would even the score.

Termination

The truckers' trek to the Court started when they were on the road one Monday morning in May 2008, in the depths of the Great Recession. That year, the airwaves were filled with Obama, McCain and Romney running for President. Jevic trucks dotted the eastern seaboard. That morning, Libby Vaughn opened a Fedex from Jevic. It told her that Sam, her husband, was terminated along with the entire Jevic workforce effective immediately. The news quickly reached the truckers. Suddenly unemployed, the truckers found their company credit cards had been stopped, stranding them without the means to buy fuel. Jevic filed its Chapter 11 petition the next day in the Delaware bankruptcy court. The truckers promptly filed their WARN Act class action.

Three months later Sam Vaughn died. His Jevic health insurance also had been cut off. Libby was interviewed by CBS News. She noted John McCain's campaign meme, "Joe the Plumber," and blamed the death of her husband, "Sam the Truck Driver" on Jevic's owner, Sun Capital Partners, for the shutdown without notice.[1]

The Leveraged Buyout

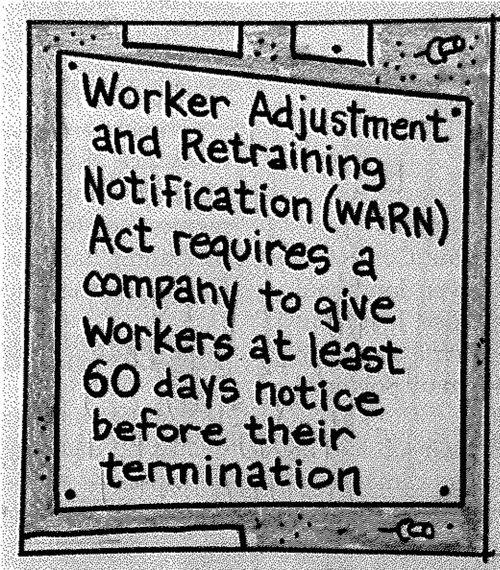
Sun Capital Partners is a private equity firm. It buys distressed companies essentially to flip them, using the high-finance version of the "fixer-upper," known as the leveraged buyout, or LBO. LBOs were pioneered in the 1980's by Michael Milken to supposedly make companies more efficient. Milken ended up in prison, but LBOs became rampant.

Sun's founders were inspired to go into the private equity/distressed company business after a visit with Mitt Romney. Romney amassed his wealth as an LBO pioneer in the 1990's at Bain Capital. Romney backed Sun's founders.[2] He apparently showed them how to use LBOs to borrow money from lender banks to buy your own "portfolio company." But you borrow the purchase money in the company's name, thus you have paid nothing from your own pocket. You owe nothing to the lenders, either. Your new portfolio company shoulders the burden of repaying the loan at high interest rates it may ill afford. If the company fails, the lenders collect their collateral to recoup their loan, and they walk away unharmed. You, the private equity owner, walk away, too, unscathed and with a potential profit.

Private equity ideally cannot lose in these deals. They extract money for themselves up front, as much as the company they buy can bear, by charging it transaction and management fees. Right away, the company is forced to pay for the privilege of being "rescued" by the financiers. The bonanza comes if the private owner can reduce the company's expenses to make the financial statement look as if the company can turn a profit: the equivalent of slapping on a coat of paint. They do that by terminating employees. If a slim profit can be shown, the private equity owner can then sell the company for a princely sum. But that still does not explain the full jackpot — how Sun's owners could make hundreds of millions of dollars so quickly. In Mitt's method, the "secret sauce" behind the enormous pay is the tax loophole known as "carried interest.[3]" Despite all their restructuring

Jack A. Raisner is a Professor of Law at Peter J. Tobin College of Business, St. John's University, New York. As a partner at Outten & Golden, LLP, the author represented the Jevic employees in this case.

and "rightsizing" prowess in turning around companies, the private equity managers pay taxes at the 15% "passive" investor capital gains income rate rather than the 35% income rate of other working people such as their secretaries and portfolio company employees. They claim even their management fees to be passive income.[4] Taxpayers end up paying for the exploit, especially the taxpaying workers who also lose their livelihoods. As *The New York Times* recently reported in an exposé-series, private equity is virtually everywhere.[5]



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Private equity argues that if a company like Jevic was so distressed in the first place, the employees could not expect continued employment. But that does not excuse being fired on the road by a Fedex coming out of nowhere taking away your income and health insurance. In 1988 Congress reacted to the devastation LBOs and other financial maneuvers were wreaking upon workers, their families and communities with the WARN Act. The New Jersey version of the federal WARN Act became law in 2007. It strictly required notice in mass layoffs or shut down by providing employers no defenses. But paying WARN is not in the private equity playbook. Rather, carrying out the game plan by using financial power to overwhelm whomever, is the order of the day.

Unsurprisingly, Sun's co-owners, Rodger Krause and Mark Leder, are stalwart Republican contributors.[6] Leder not only raised funds for Romney in 2008, he played a fateful role in 2012. Leder hosted a $50,000-a-plate Romney fundraiser at his home in Boca Raton. Romney was caught on video in Leder's dining room. There he made his infamous remark, writing off 47% of the voting public who supposedly pay no tax and believe the government has a responsibility to care for them.[7] Romney revealed himself and private equity colleagues to be out of touch rich guys. It is they who rely on the legal system to take care of their interests, at the taxpayers' expense. They unapologetically write off the have-nots, expecting the law's solid support when they go into bankruptcy court. And Sun got it.

The Bankruptcy

If private equity owners cannot make their portfolio company shine, the final act of LBO play takes place in bankruptcy court. One in five of Sun's companies ends up there.[8] In bankruptcy there is Chapter 7 liquidation, and Chapter 11 reorganization. Chapter 11 was created to rehabilitate viable companies with management still holding the reins. Hollowed-out companies are not viable and can only be liquidated — which means selling their assets for creditors and dissolving them. In Chapter 7, a trustee liquidates them at no cost to the owners. But Chapter 7 conversions are dreaded by private equity. In a Chapter 7, the disinterested trustee takes control over the estate. The trustee is empowered and financially incentivized to sue the owners for any misdeeds that contributed to the company's demise. So powerful financiers pay lots of money to use what is called a "liquidating" Chapter 11, instead, to bury their companies. They pay to hold the reins to the very end — in order to bury whatever liability they incurred along the way, in what is called the "soft landing."

The first order of business in a liquidating Chapter 11 is to sell the company's assets to make whole the secured lender. That happened in *Jevic*. The lender, CIT, recouped its loan. That done, the Chapter 11 estate then distributes its remaining assets to the unsecured creditors in accordance with the Bankruptcy Code's priority waterfall. In Jevic, the truckers stood atop the waterfall with their $12 million award, of which $8.3 million is priority. But Sun and CIT had left no cash in the estate. The waterfall was dry. In "no money" cases, creditors usually lose interest

1042 Kearny Street, San Francisco, CA 94133
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in what happens at this point. That's when Sun and CIT, however, moved in to take what they needed.

The LBO proponents want a "soft landing" in the form of releases. Sun and CIT had good reason to want such releases. They had both been sued by the Jevic Creditors' Committee. In a Chapter 11, the Official Unsecured Creditors Committee is charged with protecting estate funds. After its formation, the Unsecured Creditors Committee has the right to hire professionals — lawyers and financial analysts — who are paid for by the debtor's estate. The Committee may sue the insiders. The Committee can release the parties it sues, however, if the parties give consideration to the estate. The consideration buys the consent of the unsecured creditors to give up the lawsuit and go away. It is their "tip." The trade is a settlement that the Bankruptcy Court must approve. That's how these cases are supposed to end.

The Committee had filed an 80-page complaint claiming Sun and CIT had fraudulently transferred to Sun all of Jevic's assets without conferring any benefit to Jevic — what is known as a fraudulent conveyance. Sun acquired all of Jevic, which was worth about $100 million dollars, using CIT's money. Jevic collateralized all its assets to CIT, but all Jevic received in return was a pile of debt that it could not repay. It did not receive enough cash to make itself viable. Such complaints are routinely dismissed at the outset in a motion to dismiss. The Committee's fraudulent conveyance complaint survived that first round.

Structured Dismissal

Sun and CIT thus needed to buy releases from the lawsuit, even if it meant adding some new capital to the estate to gain the release. CIT and Sun infused another $3.7 million into the estate in exchange for being released from the Committee lawsuit. That new bankroll was divided up between the estate's and Committees' professionals. There was no other business for the bankruptcy, so it was ripe for dismissal. The cheapest way to do so is through a new mechanism known as a "structured dismissal." The parties made a motion asking the bankruptcy court to approve the settlement that had been struck, and to dismiss the bankruptcy proceeding, letting Sun and CIT walk off free of liability.

It is here, however, that the Jevic bankruptcy case took a strange turn. In the distribution to the unsecured creditors, Sun insisted that the truckers be bypassed. Under the Bankruptcy Code's priority scheme, the "absolute priority rule" dictates that their wage priority claim had to be paid first. Under Chapter 11 reorganization plan rules, the estate would have had to pay the truckers' $8.3 million priority WARN back pay claim in full, before any creditor below them received anything. Sun made it a condition of the settlement that the truckers be cut out completely from the distribution, purportedly because the truckers were also suing Sun under the WARN Act. The truckers objected that skipping over them violated the priority scheme, which is sacrosanct and can only be deviated from with their agreement.

The truckers' argument seemed rock solid. First, the bankruptcy code does not offer any route of exit that permits deviation from the priority rule. And that rule is well-established for good reason. There is the biblical injunction that workers' wages are a priority over other creditors. The earliest bankruptcy rules in the United States contained the wage priority. That it has been a "fixed principle" ever since makes sense in pure business terms. Trade creditors and unsecured lenders choose to do business with distressed companies because the potential for profit outweighs the risks. To limit their losses when they are stiffed, they can insure themselves or take other measures. They win some and lose some. Employees do not make profit, and have few choices for whom to work. Like the government waiting for taxes to be paid, they are dependent on their employers' fortunes. But the wage priority comes even before the government's taxes in the priority scheme. That may be because employees are so indispensable in stopping distressed companies from going bankrupt. Instead of working hard until the bitter end, employees would have every reason to jump ship early if they thought they would be pennies-on-the-dollar creditors for their wages in bankruptcy.

When Sun demanded that the truckers not even get a penny on the dollar for their WARN back-pay in the

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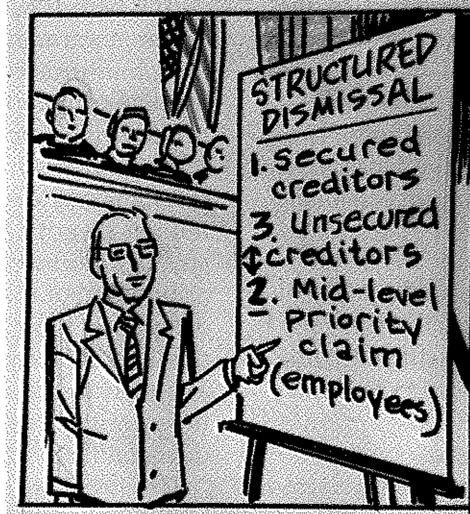
final distribution of the estate, the truckers vehemently objected. The Bankruptcy Court even acknowledged their argument that nothing in the bankruptcy code allows parties to skip over the wage priority creditors and then skip out from bankruptcy with releases. But the Bankruptcy Court ruled in favor of Sun and CIT. Approving the settlement and structured dismissal, the Bankruptcy Court reasoned that if the case had converted to Chapter 7, there would have been nothing to pay the creditors. The Bankruptcy Court accepted the estate's contention that the Committee's fraudulent conveyance lawsuit was worthless. To buy the settlement of that "worthless" action, however, Sun and CIT had infused $3.7 million into the estate. After professionals were paid, that would leave at least something for all of the other creditors. So, cutting out the truckers was acceptable because, in these "dire circumstances," half a loaf is better than none.



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The Appeal

As the first district or circuit courts in the country to hear a "structured dismissal" case of any sort, the District Court for the District of Delaware and the Third Circuit affirmed.[9] The Third Circuit majority held that "absent a showing that a structured dismissal has been contrived to evade the procedural protections . . . of the plan confirmation . . . processes, a bankruptcy court had discretion to order such a disposition" but "only if they have specific and credible grounds to justify the deviation." The Circuit panel determined that this was that rare case because the circumstances had been "dire." In such a structured dismissal the absolute priority rule does not apply. The court agreed with the assumption that the only possible settlement was one that violated the priority rule. The truckers could not really complain, because they would have gotten nothing anyway. Excluding them was a necessary evil that benefited the many at the expense of the few. Candidate Donald Trump's sister who sat on the panel, Judge Maryanne Trump Barry, asked the sharp question: was it not Sun that set up these "dire" circumstances" by wringing the last dollar out of Jevic before the bankruptcy, ensuring the circumstances would be "dire?" But she sided with the author of the majority opinion, Judge Thomas Hardiman, whose name would appear near the top of Donald Trump's short-list for Justice Antonin Scalia's seat. Yet another Presidential twist in the truckers' long haul.

A ringing dissenting opinion provided the first counterbalance. Adding more critical balance, the crack appellate practice of WilmerHale joined the truckers' team as *pro bono* appellate counsel to usher their appeal through the *en banc* rehearing stage (denied) and grant of *certiorari*, the first stroke of success. WilmerHale's team would argue at the Supreme Court.

In the year before the argument, the bankruptcy bar lit up with hot debate over *Jevic*. It was a keynote topic at virtually every bar conference, and prominent judges and commentators called it the most consequential bankruptcy case in many years.[10] In issuing its massive 10-year report with recommendations regarding the bankruptcy code, the American Bankruptcy Institute Study Commission concluded that structured dismissals should follow the priority scheme, referring to *Jevic*.[11]

The Supreme Court Rules

The Supreme Court reversed the Third Circuit in *Czyzewski v. Jevic Holding Corp.*[12] It was a 6-to-2 decision with Justice Breyer writing the majority opinion, and Justices Thomas and Alito dissenting. Justice Breyer succinctly framed the question: "Can a bankruptcy court approve a structured dismissal that provides for

The Law Office Of
Stephen M. Jackel

Social Security Disability Hearings
277 Broadway, Suite 1010 • New York, NY 10007-2001
212.393.1300 • smjlegal@gmail.com • smjlegal.com

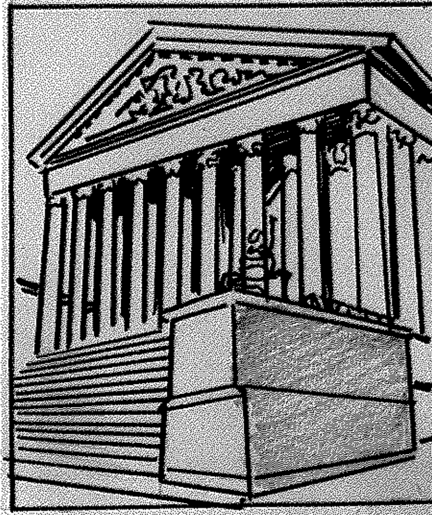
GEOFFREY SCHOTTER
ATTORNEY AT LAW

WORKERS' COMPENSATION -•- SOCIAL SECURITY DISABILITY
EMPLOYMENT DISCRIMINATION -•- CIVIL RIGHTS

65 Lenox Road #1E
Brooklyn, NY 11226
geoffrey.schotter@gmail.com
www.schotterlaw.com

distributions that do not follow ordinary priority rules without the affected creditors' consent?" to which he added "[o]ur simple answer to this complicated question is 'no.'"

The Court flatly rejected the lower courts' theory that, in effect, half a loaf is better than none. The Court saw through the collusive chicanery that created the consensus in *Jevic.* The Court recognized that the logic of the lower courts enhanced the risk of collusion, where senior and junior creditors team up to squeeze out mid-level claimants. When railroad barons tried that priority freeze-out one hundred years ago in the pre-Bankruptcy Code era, the Supreme Court stopped them. Now the Court stopped the heirs of those captains of finance. The Court re-dedicated itself to the "fixed principle" of absolute priority. The Court found "dubious" the lower courts' assumptions that the *Jevic* scenario is a "rarity." Even if cases like *Jevic* were a "rarity," Justice Breyer reasoned, they likely would be turned into the norm if the rulings below stood. The Court was not moved by the argument that truckers had nothing to gain without Sun and CIT putting in more money to gain releases. The Court credited the truckers' argument that the fraudulent conveyance claim might well have had value — some of which would have gone to the truck drivers. Why else would Sun and CIT have paid $3.7 million to make the claims against them go away?



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The Court's firm insistence that bankruptcy estates comply with priorities in the final distribution of assets is extremely significant for small, priority creditors who tend to be employees. Had the Court held otherwise, the moneyed parties would have had an open invitation to circumvent them. Owners now cannot simply keep the employees' wages in their own pockets. In the last verse of the LBO hymnal, they actually may have to pay the employees' wages.

Perhaps most importantly, Justice Breyer reset the balance of power in the legal system. He wrote that "a bankruptcy court does not have the power" to deviate from the priority scheme. Finding that the bankruptcy court lacks the *power* to approve a structured dismissal effectively bends the Code and the court back into shape. The Court's decision not only restores essential bargaining leverage to employees, casting a shadow under which an entire bankruptcy, and even pre-bankruptcy, world must now operate, but it also shifts power from the elite financiers back to the Bankruptcy Court. Courts now wield a cudgel that allows them to echo Justice Breyer's "no" to high finance shenanigans. That power was handed to them through the Supreme Court by Jevic's have-not truckers. They came away, finally, with something for themselves and others.

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8. https://thinkprogress.org/private-equity-ceo-who-reneged-on-pension-benefits-to-host-fundraiser- for-romney-6841c6bb09d7.

9. Czyzewski v. Jevic Holding Corp., 787 F.3d, 173 (3d. Cir. 2015) reversed, 2017 WL 1066259 (S. Ct. Mar. 22, 2017).

10. http://www.bankruptcylawinsights.com/2016/10/jevic-could-be-the-most-consequential- chapter-11-decision-in-many-years.

*11. See 2014 ABI Commission Report, at 269-73. Jevic, 2017 WL 1066259, slip op. at *11. Id. at *12.*

12. Czyzewski v. Jevic Holding Corp., No. 15-649, 2017 WL 1066259 (S. Ct. Mar. 22, 2017).

SERCARZ & RIOPELLE, LLP

810 7TH AVE., SUITE 620
NEW YORK, NEW YORK 10019
1-212-586-4900
FAX: 1-212-586-1234

Jay C. Carlisle
Attorney at Law
White Plains, NY
(914) 422-4234