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CLIENT ALERT

Supreme Court Provides Guidance on the Use of Structured Dismissals in Bankruptcy

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The United States Supreme Court (the "Court") recently issued a long-awaited decision in *Czyzewski v. Jevic Holding Corp*. ("*Jevic*"), which limits the use of "structured dismissals" in Chapter 11 bankruptcy cases, requiring structured dismissals pursuant to which final distributions are made to comply with the Bankruptcy Code's priority scheme, or the consent of all affected parties to be obtained.[1]

What is a Structured Dismissal?

Chapter 11 cases are typically resolved in one of three ways: the confirmation of a reorganization (or liquidation) plan; conversion to a Chapter 7 liquidation; or dismissal. Sections 1112(b) and 305(a) of the Bankruptcy Code permit dismissal. However, they do not address the scope and what can be achieved thereby.[2]

Bankruptcy professionals over time have developed the "structured dismissal" as a tool to resolve certain challenging Chapter 11 cases. These structured dismissals allow for a relatively quick and inexpensive manner of distributing assets in cases where confirmation of a plan or conversion to Chapter 7 is prohibitively expensive or impractical. In a structured dismissal, certain key stakeholders resolve their disputes and seek the bankruptcy court's approval of a settlement agreement to be implemented in conjunction with the dismissal of the bankruptcy case, with most (if not all) of the settlement and resulting distributions implemented outside of the purview and jurisdiction of the bankruptcy court.

Prior to *Jevic*, bankruptcy courts at times approved structured dismissals that provided for distributions that circumvented the Bankruptcy Code's statutory priority scheme. For example, in some cases, one class of creditors would not receive any recovery, but a class junior thereto would receive a distribution.[3] Post-*Jevic*, the Court ruled that distributions pursuant to structured dismissals must comply with the Bankruptcy Code's priority scheme. So, while structured dismissals will still exist post-*Jevic*, junior creditors may not recover thereunder prior to creditors of a senior priority receiving a complete recovery or otherwise consenting to such treatment.

Background

In 2006, Sun Capital Partners acquired trucking company Jevic Transportation Corporation in a leveraged buyout. Two years after the leveraged buyout, Jevic filed for Chapter 11 bankruptcy in Delaware. Following the filing, a group of Jevic's former employees commenced an adversary proceeding against Jevic alleging violations of federal and state Workers Adjustment and Retraining Notification (WARN) Acts. The WARN Act claimants subsequently received a $12.4 million judgment and asserted an $8.3 million priority claim in Jevic's bankruptcy case on account of that judgment. This WARN Act claim was statutorily senior in right of payment to general unsecured claims in Jevic's bankruptcy case.

At the same time that Jevic was being sued for WARN violations, the Creditors' Committee commenced fraudulent conveyance actions against Jevic's present and former shareholders, Sun Capital and CIT, arising from the leveraged buyout (the "2006 LBO Claims"). In 2012, the Committee, Jevic, CIT, and Sun negotiated a settlement

agreement that called for a structured dismissal of Jevic's Chapter 11 case and a settlement of the 2006 LBO Claims that provided for a recovery by general unsecured creditors, but no recovery for the WARN Act creditors, notwithstanding that their claims were liquidated and senior in priority to the general unsecured creditors' claims. The WARN Act claimants and the U.S. Trustee objected to the settlement.

The Bankruptcy Court approved the settlement, reasoning that the Bankruptcy Code's priority scheme did not apply because the payouts would occur pursuant to a structured dismissal and not a Chapter 11 plan (confirmation of which the Bankruptcy Court deemed an impossibility). Furthermore, the Bankruptcy Court emphasized that, absent approval of the structured dismissal, the "dire circumstances" present in Jevic's bankruptcy case would result in "no realistic prospect" of a meaningful distribution for anyone other than the secured creditors.[4] On appeal, the District Court and the Third Circuit affirmed the Bankruptcy Court's ruling on similar grounds, concluding that non-consensual, priority-violating structured dismissals were acceptable in "rare case[s]" in which courts could find "sufficient reasons" to deviate from the Bankruptcy Code's priority scheme.[5]

Supreme Court Analysis

The Court reversed the rulings of the lower courts and held that the structured dismissal in *Jevic* impermissibly violated the Bankruptcy Code's priority rules.

The Court observed that a dismissal of a bankruptcy case typically returns the debtor to the financial status quo as it existed immediately prior to the commencement of the case; when this is impossible, a "structured dismissal" allows a Bankruptcy Court to dismiss a case with certain conditions "for cause." The Court expressly declined to rule on the legality of structured dismissals in general but noted that multiple prior decisions approved structured dismissals with the consent of all affected parties.

The Court recognized that cases exist in which courts have approved interim distributions that violate the ordinary priority rules. However, the Court emphasized that "in such instances, one can generally find significant [Bankruptcy]

Code-related objectives that the priority-violating distributions serve."[6] The Court noted that common examples are found in the "first day" orders entered by bankruptcy courts in many cases, such as "wage orders" that allow payment of employees' prepetition wages, "critical vendor" orders that allow payment of essential suppliers' prepetition invoices, and "roll-ups" that allow lenders who continue financing the debtor to be paid first on their prepetition claims, because they enable a "successful reorganization and make even the disfavored creditors better off."[7]

In *Jevic*, however, the Court held that the "cause" necessary to approve a deviation from the Bankruptcy Code's priority scheme is unlikely to ever exist if such distribution represents the final distribution. The Court stated that in a structured dismissal "the priority-violating distribution is attached to a final distribution; it does not preserve the debtor as a going concern; it does not make the disfavored creditors better off; it does not promote the possibility of a confirmable plan; it does not restore the status quo ante; and it does not protect reliance interests."[8] The Court rejected the lower courts' establishment of a "rare case" exception to the Bankruptcy Code's priority scheme based on the existence of "sufficient reasons."[9] Citing inevitable uncertainty, the Court reasoned that the use of a "rare

case" exception might open the floodgates, tempting debtors and creditors to argue every case is the "rare case" necessitating deviation from the Bankruptcy Code's priority scheme.[10]

Implications

Jevic marks the end of structured dismissals in which final distributions deviate from the Bankruptcy Code's priority scheme without affected creditors' consent, thereby limiting, but not eliminating, their effectiveness in the commercial bankruptcy world. While *Jevic* limits structured dismissals, the door left open by the Court means that they remain an arrow in the quiver for the resolution of bankruptcy cases, albeit on a consensual basis.

What is not yet known is what impact *Jevic* will have on other areas of complex bankruptcy practice: in a Chapter 11 plan, can senior creditors "gift" portions of their recovery to junior creditors while skipping classes of creditors? Can settlements during a Chapter 11 case, which do not result in a dismissal, deviate from the Bankruptcy Code's priority scheme? *Jevic* did not expressly answer these questions, but professionals who sometimes use these tools in efforts to resolve cases with major obstacles will look to *Jevic* for insight when confronted with developing an exit to a difficult bankruptcy case.

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1 *Czyewski v. Jevic Holding Corp*., 580 U.S. ___ (2017).

2 Section 1112(b)(1) of the Bankruptcy Code authorizes a bankruptcy court, upon motion of a party in interest and following notice and a hearing, to either convert a Chapter 11 case to a Chapter 7 liquidation or to dismiss a Chapter 11 case, "whichever is in the best interests of creditors and the estate, for cause." Section 1112(b)(4) of the Bankruptcy Code defines "cause" as including "diminution of the estate and the absence of a reasonable likelihood of rehabilitation." Section 305(a)(1) of the Bankruptcy Code provides that a bankruptcy court may dismiss a bankruptcy case if "the interests of the creditors and the debtor would be better served by such dismissal."

3 *See e.g*., In re Iridium Operating LLC, 478 F.3d 452, 464-65 (2nd Cir. 2007).

4 Jevic at 8.

5 *Id*. at 8-9.

6 *Id*. at 15.

7 *Id*. at 15-16. In approving these deviations from the priority scheme, bankruptcy courts generally rely on section 105(a) of the Bankruptcy Code, which provides that a Bankruptcy Court "may issue any order, process, or judgment that is necessary or appropriate to carry out the [Bankruptcy Code's] provisions."

8 *Id* at 16. Query whether the Jevic WARN creditors were not, in fact, worse off because they lost their ability to pursue their state law fraudulent transfer claims and other similar claims.

9 *Id*. at 16-17.

10 *Id*. At 17.

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