Alert

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Bankruptcy, Insolvency & Restructuring Alert
News Concerning Recent Bankruptcy Decisions

COZEN O'CONNOR

U.S. Supreme Court Significantly Limits Structured Dismissals

When a company files for Chapter 11 bankruptcy, generally three options are available for the company's emergence from bankruptcy. The options include a confirmed plan of reorganization, conversion to a liquidation under Chapter 7 of the Bankruptcy Code, or dismissal of the bankruptcy and a return of all parties to their pre-bankruptcy positions. Dismissal of the bankruptcy may take several forms, including dismissal with distribution to certain creditors over others. However, after the U.S. Supreme Court's recent decision in *Czyzewski v. Jevic Holding Corp.*, decided March 22, 2017, options for dismissal are now more limited. 580 U.S. ___ (2017) (slip op.). Pursuant to *Jevic*, structured dismissals must now either comply with the Bankruptcy Code's basic priority scheme or have the consent of creditors that the structured dismissal seeks to avoid.

If no plan can be confirmed, and conversion to a Chapter 7 liquidation is undesirable, a debtor-in-possession may seek dismissal of the case, returning the parties to their pre-bankruptcy positions. Structured dismissals come about in situations where conditions may have changed during the bankruptcy process, rendering a return to the pre-bankruptcy status quo difficult or impossible. In these situations, the Bankruptcy Code allows a Bankruptcy Court to alter the Chapter 11 dismissal's restorative consequences "for cause." As noted in *Jevic*, the American Bankruptcy Institute defines a structured dismissal as a "hybrid dismissal and confirmation order … that … typically dismisses the case while, among other things, approving certain third-party releases, enjoining certain conduct by creditors, and not necessarily vacating orders or unwinding transactions undertaken during the case."

Distributions to a bankrupt's creditors generally follow the scheme laid out by Congress in the Bankruptcy Code. These distributions begin with secured creditors that have liens on a debtor's collateral, then go to administrative creditors, and down the waterfall of priority creditors codified in the Bankruptcy Code, ending with general, unsecured nonpriority creditors, and, if anything remains, the bankrupt's equity holders. At issue before the Court in *Jevic* was whether a structured dismissal must also follow this basic distribution scheme. In its narrow opinion on the matter, the Court held that structured dismissals must adhere to this scheme, unless the skipped-over creditors consent.

Background

In 2006, Jevic Transportation Corporation was acquired by a private equity firm through a leveraged buyout. Two years later, Jevic filed for Chapter 11 bankruptcy. The bankruptcy filing led to two lawsuits. In the first, former Jevic employees sued under the Worker Adjustment and Retraining Notification Act (the WARN Act), alleging that they did not receive the WARN Act's required 60-day notice prior to termination. The Bankruptcy Court granted summary judgment in favor of the former employees, resulting in a judgment that the former employees claimed was worth $12.4 million. Of that total, $8.3 million would be entitled to priority wage classification pursuant to 11 U.S.C. § 507(a)(4). In the normal bankruptcy distribution scheme, the $8.3 million would receive priority over — and payment before — certain of the debtor's other creditors, including general, unsecured nonpriority creditors.

The second suit was brought by a committee of Jevic's unsecured creditors against the private equity firm and the lender from the leveraged buyout. This suit alleged that the leveraged buyout "hastened Jevic's bankruptcy by saddling it with debts that it couldn't service." The parties to this suit reached a settlement agreement, which, pending approval by the Bankruptcy Court, was conditioned on a structured dismissal of the bankruptcy. The structured dismissal would have resulted in the payment of certain of the debtor's administrative expenses and taxes, followed by a distribution of the remainder of funds *pro rata* to the general, unsecured nonpriority creditors. This

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would have skipped any distribution to the former employees on their $8.3 million priority wage claim stemming from the WARN action.

Over the objection of the WARN claimants, the Bankruptcy Court approved the settlement and structured dismissal, as the Bankruptcy Court believed that without the settlement, there would be no realistic possibility of a meaningful distribution to unsecured creditors. In approving the settlement, the Bankruptcy Court noted that a confirmed plan was unattainable, and if the case were converted to a Chapter 7, no funds would exist to administer the case. The district court and court of appeals affirmed.

The Supreme Court's Opinion

The Supreme Court disagreed. The Court noted that the Bankruptcy Code's "priority system constitutes a basic underpinning of business bankruptcy law … [and the Court] would expect to see some affirmative indication of intent if Congress actually meant to make structured dismissals a backdoor means to achieve the exact kind of nonconsensual priority-violating final distributions that the Code prohibits in Chapter 7 liquidations and Chapter 11 plans."

While the Court did except common Chapter 11 practices that depart from rules and timing of distributions, such as "First Day" orders paying prepetition wages and critical vendors, the Court stated that a structured dismissal, being attached to a final disposition, "does not preserve the debtor as a going concern." As such, a structured dismissal deviating from the Bankruptcy Code's priority scheme was impermissible without the consent of the affected parties. The Court's analysis of the proposed distributions through the settlement and structured dismissal saw those distributions "more closely resembl[ing] proposed transactions that lower courts have refused to allow on the ground that they circumvent the Code's procedural safeguards[,]" as opposed to having "any significant offsetting bankruptcy-related justification."

The Court also noted that the Bankruptcy Court's opinion that there would be no distribution to creditors without the settlement was not supported by the record. The Court stated that the underlying suit could have been successful on the merits, thus bringing money into the debtor's estate for distribution to creditors. This supported the WARN claimants' standing to object to the structured dismissal and also refuted the Bankruptcy Court's justification for approving the settlement.

Takeaways

The Court's decision in *Jevic* mandates that a structured dismissal adhere to the absolute priority rule. Thus, creditors who perceive that a structured dismissal will result in a distribution that is not in keeping with the basic priority structure of the Bankruptcy Code can rely on *Jevic* to object to the dismissal. As for debtors seeking an exit from Chapter 11 proceedings when no confirmed plan seems tenable, it appears that they must convert the case to Chapter 7 or proceed with a structured dismissal that complies with the Bankruptcy Code's distribution scheme. The result may be that more cases find their way to the Chapter 7 trustees.

To discuss any questions you may have regarding the opinion discussed in this Alert, or how it may apply to your particular circumstances, please contact a member of Cozen O'Connor's Bankruptcy, Insolvency & Restructuring Practice Group.