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Feature

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Re-"Structuring" Dismissal Flexibility

An Analysis of the Supreme Court's Jevic *Decision*

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Editor's Note: *ABI held a media webinar in March 2017 examining the Supreme Court's ruling in* Jevic. *Experts included Prof.* ***Jonathan C. Lipson*** *of Temple University School of Law, who was counsel of record for an* amicus *brief from law professors in favor of the petitioner;* ***David R. Kuney*** *of Whiteford Taylor Preston, LLP, who was the counsel of record for an* amicus *brief by another set of law professors in support of the respondents; and ABI's Spring 2017 Resident Scholar Prof.* ***Andrew Dawson*** *of the University of Miami School of Law. ABI Editor-at-Large* ***Bill Rochelle*** *moderated the webinar. For a replay, visit abi.org/educational-brief/examining-the-supreme-courts-ruling-in-czyzewski-v-jevic-holding-corp.*

A chapter 11 case generally ends in one of three ways: (1) the debtor confirms a plan; (2) the case is converted to chapter 7; or (3) the court dismisses the case. Under the last option, the dismissal restores the parties to the status quo ante (*i.e.*, the positions held before bankruptcy) unless the bankruptcy court orders otherwise for cause.[1] With this perceived flexibility, some debtors have turned to "structured dismissals" as a less-onerous alternative to the traditional plan process.

Structured dismissals are a hybrid of a standard dismissal and a confirmation order. They end a bankruptcy case on certain conditions and with bargained-for protections (such as releases, distributions and the continued vitality of bankruptcy court orders) rather than simply restoring the status quo.[2] From start to finish, a structured dismissal is faster and requires less resources than a typical plan process. Therefore, structured dismissals have become an acceptable alternative for chapter 11 debtors that are unable to satisfy — or face significant hurdles in trying to satisfy — the requirements of plan confirmation.[3] In short, they represent a pragmatic resolution to difficult cases. In the much-awaited decision in *Czyzewski v. Jevic Holding Corp.*,[4] the U.S. Supreme Court dealt a blow to debtors hoping to use structured dismissals as a cost-saving alternative to the complex and expensive issues that accompany plan confirmation.

The Facts

The circumstances leading to the *Jevic* opinion emanate from a leveraged buyout (LBO). Specifically, in 2006, Sun Capital Partners purchased the stock of Jevic Transportation Corp. with funds that Sun Capital borrowed from CIT Group.[5] Sun Capital then granted CIT Group a security interest in Jevic's assets, thereby elevating CIT Group's interests above Jevic's general unsecured creditors.[6] Within two years of the LBO, Jevic sought chapter 11 relief.

As is typical following failed LBO transactions, litigation ensued in the bankruptcy case as creditors sought to vindicate their rights. In the first case, a group of former truck drivers sued Jevic and Sun Capital for failing to comply with state and federal Worker Adjustment and Retraining Notification (WARN) Acts, which require 60 days' advance notice before termination. While Sun Capital eventually prevailed on its appeal to the Third Circuit Court of Appeals, the bankruptcy court granted partial summary judgment against Jevic in favor of the drivers, a judgment purportedly worth $12.4 million.[7] Of that total, approximately

1 *Lawson v. Tilem (In re Lawson)*, 156 B.R. 43, 45 (B.A.P. 9th Cir. 1993) (citing 11 U.S.C. § 349).
2 *Czyzewski v. Jevic Holding Corp.*, No. 15-649, 2017 WL 1066259, at *5 (March 22, 2017) (citing ABI Commission to Study the Reform of Chapter 11, 2012-2014 Final Report and Recommendations 270 (2014), *available at* commission.abi.org/full-report).
3 Patrick R. Mohan, "How 'Absolute' Is the Absolute Priority Rule: Structured Dismissals Following *Jevic Holding Corp.*," 25 No. 1 *J. Bankr. L. & Prac. NL* Art. 3 (2016).
4 No. 15-649, 2017 WL 1066259 (March 22, 2017).
5 *Jevic*, 2017 WL 1066259 at *6.
6 *Id.*
7 *Id.*

$8.3 million constituted priority wage claims under § 507(a)(4) of the Bankruptcy Code and qualified for payment ahead of general unsecured creditors.[8]

In the second lawsuit, Jevic's official committee of unsecured creditors sued Sun Capital and CIT Group, alleging that both entities hastened Jevic's bankruptcy filing by allowing Jevic to incur debt that it could not service.[9] In 2011, the bankruptcy court held that the committee's complaint adequately pled claims for the avoidance of preferential and fraudulent transfers. At that juncture, Jevic's only assets included the committee's claims and $1.7 million in cash subject to Sun Capital's lien.[10]

The committee, Sun Capital, Jevic and CIT Group ultimately reached a settlement of the fraudulent transfer lawsuit, which provided for (among other things) an assignment of Sun Capital's lien on Jevic's cash to a trust, which would distribute those funds to certain creditors in exchange for a dismissal of the bankruptcy case.[11] Notably, the settlement did not provide for any distribution on the WARN claimants' priority-wage claims. Instead, it provided for a *pro rata* distribution to Jevic's general unsecured creditors in contravention of the Bankruptcy Code's payment hierarchy.[12]

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Nevertheless, the bankruptcy court approved the structured dismissal in light of the dire circumstances facing the estate.[13] Specifically, the bankruptcy court found that confirmation of a chapter 11 plan was unattainable. The court further found that the alternative (conversion to chapter 7) was not feasible because the estate lacked the funds that were necessary to wind down the estate.[14] The WARN claimants, who received nothing on account of their priority claims, appealed.

On appeal, the district court affirmed the bankruptcy court's decision. It recognized that the distribution scheme violated the Bankruptcy Code's priority rules applicable to plans, but noted that the settlement was not a plan.[15] Similarly, the Third Circuit Court of Appeals affirmed, reasoning that Congress codified the absolute priority rule in the *specific* context of plan confirmation.[16] As such, the Third Circuit concluded that structured dismissals that deviate from the Bankruptcy Code's priority scheme might be appropriate in "rare" instances.[17]

Undeterred, the WARN Act claimants sought *certiorari*, which the Supreme Court granted. On March 22, 2017, amid buzz regarding the potential ramifications of a broad opinion, the Supreme Court reversed, holding that a bankruptcy court may not approve a structured dismissal that deviates from traditional priority principles absent consent from the affected creditors.

The Ruling [18]

The Majority Decision

The majority opinion by Justice Stephen Breyer began its analysis by emphasizing the importance of the Bankruptcy Code's priority system as a fundamental underpinning of business bankruptcy law.[19] While stressing that a distribution of estate assets through a chapter 7 liquidation or pursuant to a chapter 11 plan must comply with the Bankruptcy Code's priority rules, the Supreme Court recognized the differences between the two chapters.[20] In chapter 7, distributions must adhere to strict priority rules; lower-priority creditors cannot receive anything until higher-priority creditors have been paid in full.[21] While chapter 11 plans are more flexible, the Bankruptcy Code similarly forbids confirmation of a priority-violating plan over the objection of an impaired class of creditors.[22] Had Congress intended to depart from these fundamental constructs, it would have done so through more than mere silence.[23] In other words, structured dismissals cannot circumvent otherwise-applicable priority rules.

The majority then examined § 349(b) of the Bankruptcy Code, which codifies the principle that a dismissal generally should restore the status quo.[24] While § 349 permits a bankruptcy judge to alter the status quo "for cause," the Supreme Court reasoned that this flexibility was designed *only* to protect rights acquired in reliance on the bankruptcy case.[25] Accordingly, the Court found that the cause standard is "too weak" to authorize a structured dismissal that violates otherwise-applicable priority rules without the consent of impaired creditors.[26]

Further, the Supreme Court acknowledged that lower courts have approved interim distributions that violate ordinary priority rules, such as pre-petition employee-wage orders, critical-vendor orders and debtor-in-possession (DIP) financing "roll-ups."[27] While the Court did not address the legality of these distribution mechanisms, it recognized that interim payments in those circumstances can serve important bankruptcy objectives, such as the preservation of the debtor's going-concern value.[28] In contrast, the structured dismissal in *Jevic* did not serve any "significant

8 *Id.*
9 *Id.* at *7.
10 *Id.*
11 *Id.* The settlement also required CIT Group to deposit $2 million into a designated account for the payment of the committee's legal fees and administrative expenses. *Id.*
12 *Id.*
13 *Id.* at *8.
14 *Id.*
15 *Id.* (citing *In re Jevic Holding Corp.*, Civ. Nos. 13-104-SLR and 13-105-SLR, 2014 WL 268613, at *3 (D. Del. Jan. 24, 2014)).
16 *Id.* at *8.
17 *Id.*; *Official Comm. of Unsecured Creditors v. CIT Grp./Bus. Credit Inc. (In re Jevic Holding Corp.)*, 787 F.3d 173, 185-86 (3d Cir. 2015).

18 In addition to the ruling described below, the Supreme Court found that the petitioners had Article III standing because they had suffered a compensable loss. *Jevic*, 2017 WL 1066259, at *8.
19 *Id.* at *10.
20 *Id.*
21 *Id.* (citing 11 U.S.C. §§ 725 and 726).
22 *Id.* (citing 11 U.S.C. § 1129(b)).
23 *Id.*
24 *Id.* at *11.
25 *Id.*
26 *Id.*
27 *Id.* at 12 (citations omitted).
28 *Id.*

offsetting bankruptcy-related justification."[29] It did not preserve the debtor as a going concern, improve the position of disfavored creditors, restore the status quo or promote the possibility of a confirmable plan.[30]

Finally, the Supreme Court rejected any attempt to limit nonconsensual priority-violating structured dismissals to "rare" cases,[31] reasoning that even a narrow exception untethered to precise guidelines threatens to swallow the rule.[32] With no guideposts to determine a "rare case," the Court argued that such an exception results in uncertainty and potentially grave consequences in the bankruptcy process, such as collusion and changes in bargaining power.[33] Therefore, in an effort to achieve predictability, the Court declined to adopt a "rare case" exception.

The Dissent

In an ironic twist, the dissent departed from the majority on the basis that the issuance of the opinion itself violated the Supreme Court's procedural requirements.[34] More particularly, the Court granted *certiorari* to determine whether a bankruptcy court could authorize the distribution of settlement proceeds in a manner that violates the Bankruptcy Code's statutory priority scheme.[35] Petitioners later narrowed this issue, questioning "[w]hether a Chapter 11 case [might] be terminated by a 'structured dismissal' that distributes estate property in violation of the Bankruptcy Code's priority scheme."[36] The dissent reasoned that this new question was narrower in scope than its predecessor and was not the subject of a circuit split.[37] Therefore, Justices Clarence Thomas and Samuel Alito asserted that it was unwise to address a novel issue in the rapidly developing field of structured dismissals without the benefit of additional insight from the courts of appeals and without the benefit of a full briefing.[38] They further asserted that deciding the reframed issue rewarded petitioners' "bait-and-switch" maneuver — a potentially problematic precedent.[39] However, the dissent did not hint at how they might have otherwise decided the original issue.

Conclusion: What Is In, What Is Out and What Is Uncertain

Before the *Jevic* decision, certain bankruptcy commentators feared the worst. A broad opinion that invalidated structured dismissals generally on the basis of a lack of specific statutory authority could have significantly impaired the ability of practitioners to adapt to difficult situations. The Supreme Court did not go that far. Aside from its specific holding, the *dicta* and legal reasoning in *Jevic* might nonetheless impact a variety of chapter 11 issues moving forward.

First, the decision might be seen as impliedly condoning the continued use of interim-distribution mechanisms (such as pre-petition employee-wage and critical-vendor orders and DIP financing "roll-ups") under certain circumstances — *e.g.*, so long as they foster a potential for a successful reorganization. *Jevic* will likely be cited in support of these common requests and potentially as a basis for other creative forms of interim relief.

While the Supreme Court declined to adopt a *per se* rule, the functional effect of its ruling might make structured dismissals prohibitively expensive.

Practitioners should also expect additional scrutiny of any priority-violating gifts as lower courts grapple with the bounds of *Jevic*, especially in the face of creditor dissent. However, to the extent that these "gifts" consist of *non-estate* assets or *interim* settlement distributions,[40] *Jevic*'s rationale might carry less weight.

Moreover, the Supreme Court's analysis of the strength of the "cause" language in § 349(b) may shape the lower courts' interpretation of discretionary standards throughout the Bankruptcy Code.[41] At a minimum, in light of *Jevic*, practitioners should consider providing courts with detailed evidence when requesting relief that is not specifically authorized by the Code.[42]

Finally, the future viability of structured dismissals as a cost-saving exit strategy remains unclear. While the Supreme Court declined to adopt a *per se* rule, the functional effect of its ruling might make structured dismissals prohibitively expensive. Moreover, the opinion leaves open the question of what type of consent is sufficient to depart from the Bankruptcy Code's priority scheme. Will lower courts require some form of solicitation and voting, which could eviscerate the very cost and time savings that structured dismissals are designed to achieve? Will courts impute consent following the expiration of a notice and objection period?[43] Or will cash-strapped debtors find it easier to simply convert to chapter 7 rather than risk prolonged and uncertain litigation over these issues? While *Jevic* limits a debtor's ability to propose flexible alternatives to exit bankruptcy, it remains to be seen how far the decision can and will be stretched. abi

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29 *Id.*
30 *See id.* at *13 (citing *In re Braniff Airways Inc.*, 700 F.2d 935 (5th Cir. 1983); *In re Lionel Corp.*, 722 F.2d 1063 (2d Cir. 1983); *In re Biolitec Inc.*, 528 B.R. 261 (Bankr. D.N.J. 2014)).
31 *Id.* at *13-14.
32 *Id.* at *13.
33 *Id.* at *14.
34 *Id.* at *15.
35 *Id.*
36 *Id.*
37 *Id.*
38 *Id.*
39 *Id.*
40 *See id.* at *12 (distinguishing *In re Iridium Operating LLC*, 478 F.3d 452 (2d Cir. 2007), on basis that *Iridium* approved interim, not final, distributions).
41 *See, e.g.*, 11 U.S.C. §§ 105(a), 362(d)(1), 363(c), 930(a), 1104(a)(1) and 1304(b).
42 For example, such evidence might include testimony regarding how the requested relief furthers the estate's prospects for rehabilitation, preserves going-concern value, fosters settlements, preserves bargaining power or otherwise tracks the articulated rationales that distinguish potentially permissible interim relief from an impermissible structured dismissal.
43 The unanswered-consent question opens the door to a follow-on opinion similar to the Supreme Court's decision in *Wellness Int'l Network Ltd. v. Sharif*, 135 S. Ct. 1932 (2015), which clarified the consent questions raised in the wake of *Stern v. Marshall*, 564 U.S. 462 (2011).