Jevic: Structured Dismissals Must Respect Creditor Priority, but Survive Supreme Court Scrutiny (For Now)

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Over the past few years, structured dismissals have become an increasingly popular exit strategy among creative and cash-strapped Chapter 11 debtors. Traditional avenues for concluding a Chapter 11 bankruptcy can be costly and time-consuming. Confirmation of a Chapter 11 plan typically requires extensive negotiations among the debtor and its various creditor constituencies followed by a two-stage disclosure and voting process. Debtors must weigh the risk of a contested confirmation hearing against the cost of a prolonged stay in Chapter 11, and often propose multiple plan iterations before obtaining sufficient creditor support. Unless they agree to less favorable treatment, creditors must be paid in accordance with the Bankruptcy Code's strict hierarchy and plans that do not conform to the applicable rules of priority cannot be confirmed. Conversion to Chapter 7 – the customary approach for Chapter 11 debtors lacking the financial wherewithal to continue their reorganization efforts – involves the appointment of a trustee who must examine the case with fresh eyes and distribute available funds according to the Bankruptcy Code's prescribed hierarchy. Even an efficient Chapter 7 trustee can quickly consume what limited funds might otherwise be available to pay creditors.

Faced with these unappealing alternatives, resourceful debtors have forged a third exit strategy: the structured dismissal. Section 349 of the Bankruptcy Code provides that, "[u]nless the court, for cause, orders otherwise," the dismissal of a case returns the debtor and its creditors to their pre-bankruptcy status quo. While Section 349 is ostensibly intended to describe the *effect* of dismissal, enterprising debtors – often with the support of creditors eager to keep limited funds from being depleted by Chapter 7 administrative costs – have seized upon Section 349's "[u]nless the court, for cause, orders otherwise" language as statutory authority for a more expeditious conclusion to a Chapter 11 case in the form of a dismissal order that includes additional relief, frequently including a release of the debtor in exchange for a distribution to creditors.

After filing for Chapter 11 protection in Delaware in 2008, Jevic Holding Corporation found itself in just this predicament. Jevic's creditors fell into three classes. At the top of the hierarchy, Jevic owed $53 million to its secured creditors Sun Capital Partners and CIT Group, to which Jevic had pledged all of its assets in connection with a 2006 leveraged buyout. At the bottom of the hierarchy, Jevic owed $20 million to general unsecured creditors. Caught in the middle were Jevic's former employees, who had obtained a $12.4 million Worker Adjustment and Retraining Notification (WARN) Act judgment against Jevic, of which $8.3 million was entitled to priority wage-claim treatment. Jevic's only remaining assets were $1.7 million in cash – which was subject to Sun's lien – and a fraudulent conveyance claim against Sun and CIT for allegedly saddling Jevic with debts it couldn't service in the course of the leveraged buyout. Jevic's unsecured creditors' committee had obtained authority to pursue this fraudulent conveyance claim against Sun and CIT on behalf of the estate.

Sun and CIT reached a settlement with the committee whereby CIT would contribute $2 million to the committee's legal fees and expenses, and Sun would assign its lien on the $1.7 million in cash to a trust to pay the estate's administrative expenses, with the remainder to be distributed *pro rata* to unsecured creditors. The settlement skipped over the mid-level priority wage claimants entirely because they had also asserted WARN claims against Sun; Sun did not want to finance litigation against itself. Since the settlement blatantly side-stepped the strict hierarchy of payment that would have applied in under Chapter 11 plan or Chapter 7 liquidation, Jevic sought approval of the settlement as part of a structured dismissal. The Bankruptcy Court approved the structured dismissal, including the settlement, over the objection of the priority wage claimants, reasoning that – absent the settlement – the secured creditors' claims would consume the entire estate and neither the wage claimants *nor* the unsecured creditors would get anything. Accordingly, the settlement left unsecured creditors better off without making the wage claimants any worse off. The District Court and Third Circuit Court of Appeals affirmed the Bankruptcy Court's ruling.

In *Czyzewski v. Jevic Holding Corp.*, 580 U.S. ___ (2017), by a majority of six justices (Justices Breyer, Roberts, Kennedy, Ginsberg, Sotomayor and Kagan) to two (Justices Thomas and Alito), the U.S. Supreme Court reversed and remanded. Writing for the majority, Justice Breyer deliberately refrained from expressing any view as to the legality of structured dismissals generally, as that issue was not before the Court. Instead, the Court held more narrowly that a structured dismissal cannot be used to circumvent the priority scheme for distributions, which is fundamental to the Bankruptcy Code. The Court reasoned that, in Chapter 7, "priority is an absolute command – lower priority creditors cannot receive anything until higher priority creditors have been paid in full," and even in Chapter 11, "a priority-violating plan still cannot be confirmed over the objection of an impaired class of creditors." Because of the importance of the priority scheme, the Court reasoned that it "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 non-consensual priority-violating final distributions that the Code prohibits in Chapter 7 liquidations and Chapter 11 plans."

Although the Opinion does not reference Section 105 of the Bankruptcy Code, it interprets Section 349 in a somewhat similar manner. Section 105(a) gives bankruptcy courts broad equitable power to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]." Consistent with prevailing rules of statutory interpretation that the specific trumps the general, decisions delineating the scope of Section 105 have held that the broad equitable power contemplated therein cannot justify relief unauthorized by or inconsistent with more specific provisions of the Bankruptcy Code. Similarly, *Jevic* holds that Section 349 cannot be utilized to override other, more specific provisions of the Bankruptcy Code, which require a strict hierarchy among creditors to be followed in making final distributions. In other words, Section 349 cannot be used to justify what is tantamount to a *sub rosa* plan that would not be confirmable under Section 1129.

Though rapidly gaining in popularity, structured dismissals are relatively new phenomena and reported cases approving contested structured dismissals remain few and far between. Accordingly, appellees (and the Third Circuit) relied on cases involving *interim* (as opposed to final) distributions where deviation from the normal hierarchy among creditors was permitted. The Court distinguished such cases, in which there may be a significant countervailing bankruptcy justification, from Jevic's case, in which the priority-violating distribution did not make the objecting wage claimants better off, preserve Jevic as a going concern, promote the possibility of a confirmable plan, or restore the *status quo ante.* Additionally, the Court pointed out that, subsequent to the negotiation of the settlement, the wage claimants' WARN Act claims against Sun had been dismissed. Sun's original justification for skipping over the wage claimants had thereby evaporated, opening the door for a global settlement that would allow the wage claimants to realize some value on account of their multimillion-dollar judgment against Jevic. Moreover, the Court emphasized that tinkering with the protections given by Congress to particular classes of creditors could have potentially serious consequences, including changing the delicate balance of parties' relative bargaining power in bankruptcy cases and encouraging collusion among secured and general unsecured creditors to squeeze out priority unsecured creditors.

In a short dissent, Justice Thomas accused the priority wage claimants of "bait-and-switch tactics," saying they persuaded the Court to grant certiorari on the issue of whether a bankruptcy court may authorize the distribution of settlement proceeds in a manner that violates the statutory priority scheme, then recast the issue as whether a Chapter 11 case can be concluded using a structured dismissal that violates the priority scheme. Because structured dismissals are a novel and rapidly developing area of bankruptcy law, Justice Thomas felt that the Court would have benefitted from the views of additional courts of appeals before undertaking this issue. However, the wage claimants' gamble in reframing the issue on appeal appears to have paid off, as the majority's holding suggested that *interim* distributions may deviate from the codified hierarchy given a sufficient bankruptcy justification, while *final* distributions may not. The true test of success will come on remand, as the wage claimants will presumably try to leverage their Supreme Court victory into a larger share of the settlement spoils.

In conclusion, under *Jevic*, structured dismissals are permissible so long as they comply with the Bankruptcy Code's prescribed hierarchy for paying claims *or* the adversely affected creditors have consented to less favorable treatment. How to measure such consent may be the issue that ultimately determines whether structured dismissals are a mere fad or here to stay. A large part of structured dismissals' appeal is that they are not bogged down by the pesky solicitation and voting procedures required to confirm a plan. However – particularly in cases with no creditors' committee – adversely affected creditors may simply not have the resources to protest their unfair treatment if doing so requires hiring counsel and filing an objection as opposed to simply mailing a rejecting ballot. Perhaps by the time this more vexing issue reaches the Supreme Court, the Justices will have the benefit of additional circuit court views as structured dismissals are likely to continue to gain momentum despite the boundaries imposed by *Jevic*.

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