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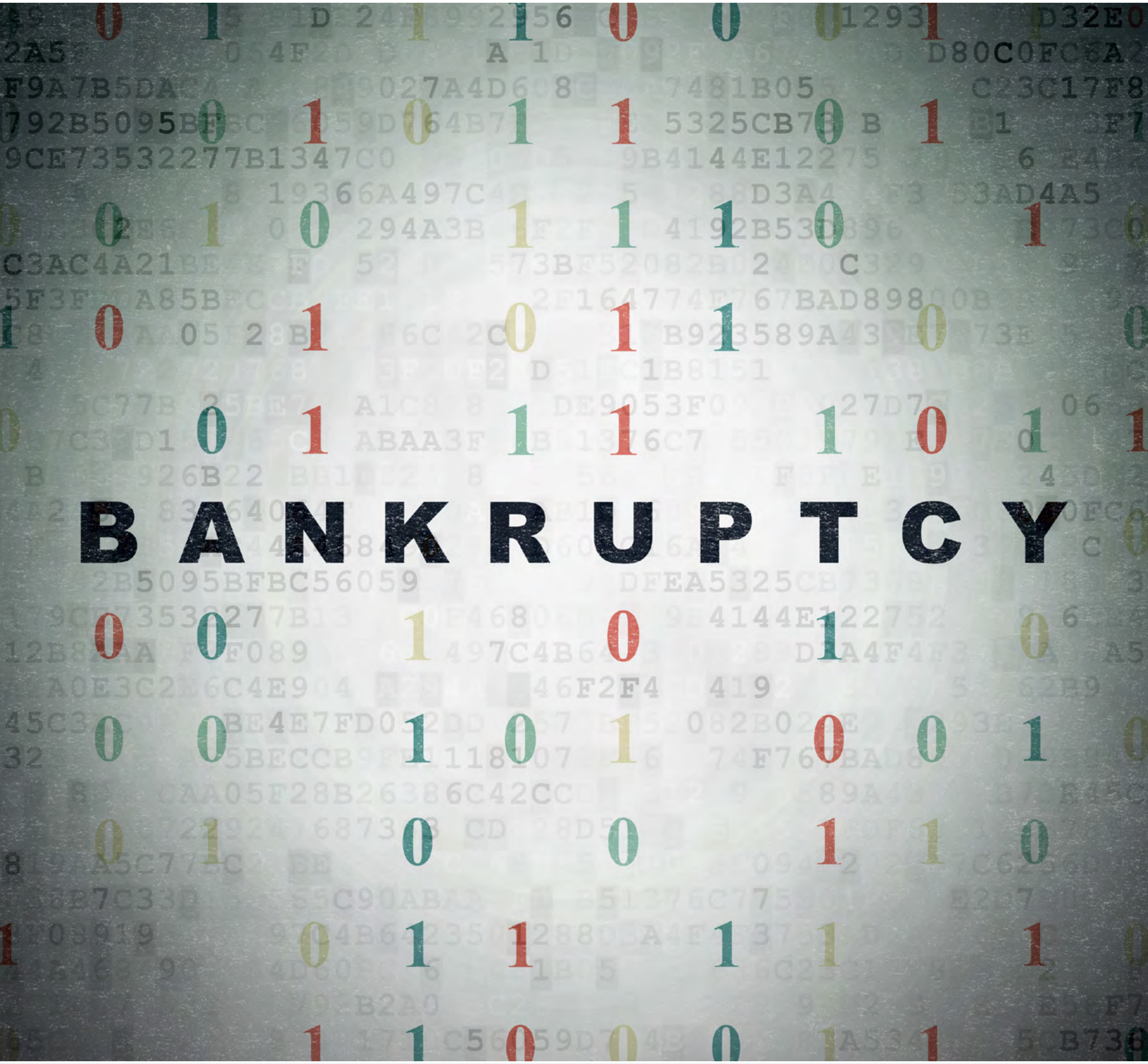

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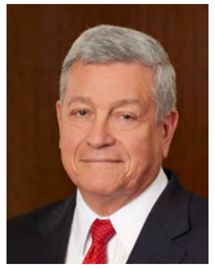

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Jevic Holdings Corp. The Death Knell For Structured Dismissals

By Peter C. Blain

On 22 March 2017, the United States Supreme Court decided *Cryzewski v. Jevic Holding Corp.,* No. 15-649, 2017 WL 1066259 (U.S. 22 March 2017), a case which addressed the use of structured dismissals to resolve proceedings under Chapter 11 of the United States Bankruptcy Code (the "Code"). 11 U.S.C. §§ 101-1532. Using structured dismissals, bankruptcy courts entered orders that dismissed bankruptcy cases, often in conjunction with the settlement of disputes, and permitted the estates to skip paying senior classes of creditors but nonetheless pay subordinate classes. The Supreme Court's decision makes clear that this popular mechanism to cheaply settle disputes and to distribute estate assets outside of the Code's priority scheme is prohibited.

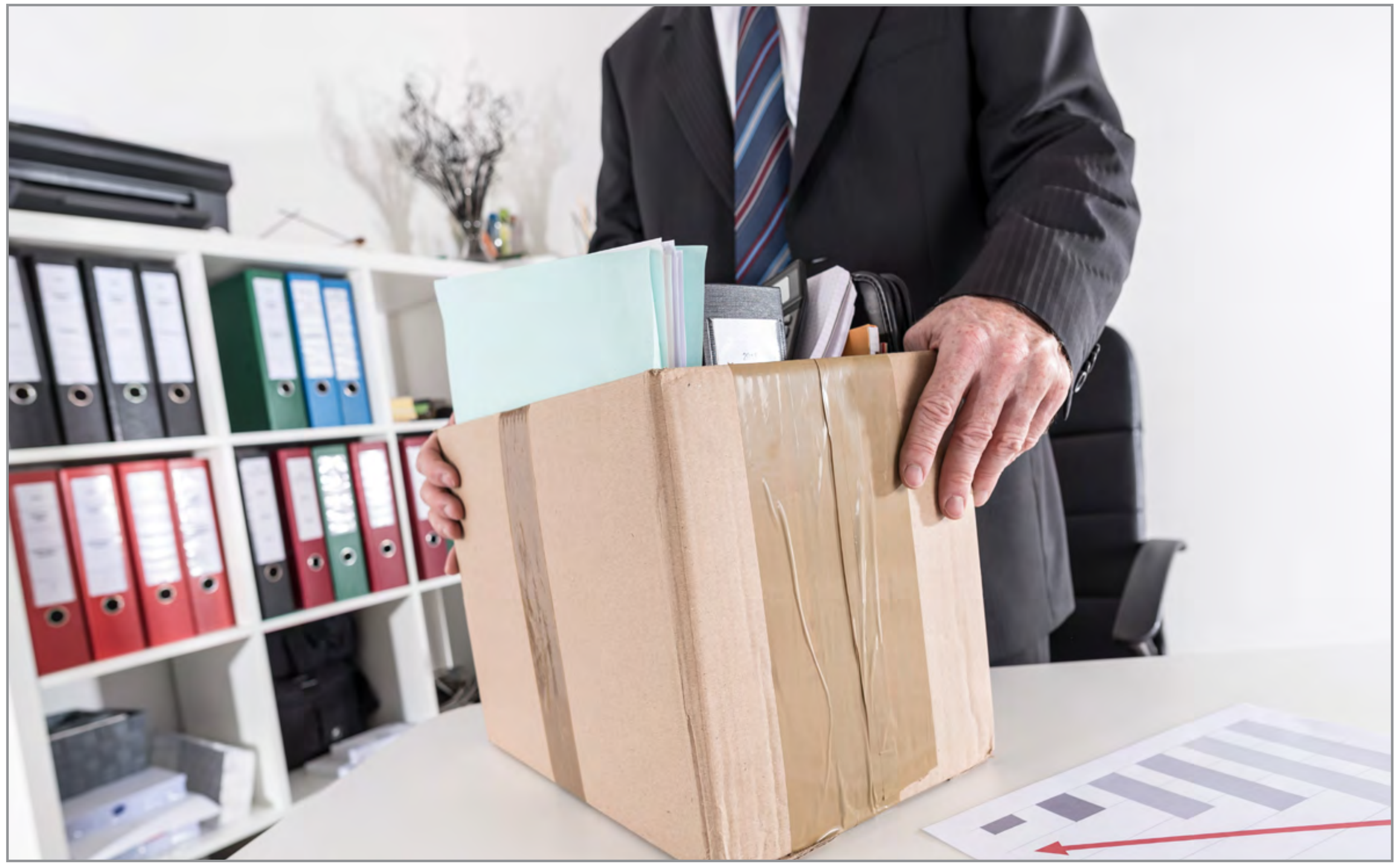
The Facts

Jevic Holdings Corp. filed a Chapter 11 petition after being purchased in a failed leveraged buyout. After the commencement of the case, the Bankruptcy Court granted Jevic's employees an $8.3 million priority claim for Jevic's failure to give the employees the required 60-day notification prior to terminating the employees under the federal Workers Adjustment and Retraining Notification ("WARN") Act and a New Jersey analog. The Jevic employees also sued the purchaser, Sun Capital Partners ("Sun"), for violating the WARN Act. In addition, the Bankruptcy Court authorised Jevic's Unsecured Creditors' Committee (the "Committee") to sue Sun and Sun's lender, CIT Group ("CIT"), under fraudulent conveyance theories asserting that Sun and CIT saddled Jevic with debts it could not pay.

As the case progressed, the only assets in the Jevic estate were the fraudulent conveyance claim and $1.7 million in cash, which was subject to Sun's lien. Sun, CIT, Jevic and the Committee eventually agreed to settle the fraudulent conveyance action on terms which provided that the action would be dismissed with prejudice; CIT would deposit $2 million into an account earmarked to pay the Committee's legal fees and administrative expenses and Sun would assign its lien the $1.7 million cash pool to a trust which would pay taxes and administrative expenses. The remainder of the funds would be paid to unsecured creditors. However, Sun insisted that there be no distribution to the higher-ranking priority claims of the Jevic employees because Sun did not want to finance the employees' pending WARN Act lawsuit against it.

The United States Trustee and the employees objected to the settlement, asserting that it violated the priority scheme mandated by the Code. The Bankruptcy Court acknowledged the abrogation of the Code's priority rules, but nonetheless approved the settlement. The Bankruptcy Court concluded that the settlement payments would occur pursuant to a structured dismissal instead of a plan of reorganisation; that the dire circumstances of the debtor made confirmation of a plan impossible; and that failure to approve the settlement would preclude a distribution to all but the secured creditors.

The employees appealed to the United States District Court (which affirmed), and then to the Third Circuit Court of Appeals, which also affirmed. The Third Circuit ruled that the priority scheme was only codified in the Code's provisions dealing with confirmation



of a plan, and that in rare circumstances (such as this one), courts could approve structured dismissals which altered the Code's strict priority rules. The employees petitioned the United States Supreme Court, which agreed to hear the case to resolve the issue of the propriety of priority-skipping structured dismissals.

The Court's Decision - Standing

The respondents admitted that the settlement abrogated the Code's priority scheme, but argued that the employees would have received nothing if the settlement had not been approved, and would also receive nothing if the structured dismissal was undone. The Court tersely summarised respondents' argument: "No loss. No redress." *Id.* at *9. The Court noted that this conclusion rested upon two assumptions. First, that without a violation of the priority rules, there would be no settlement. Second, that the fraudulent conveyance lawsuit had no value. The Court found these assumptions unsupported by the record.

The Court noted that during the pendency of the appeal, Sun prevailed in the WARN Act suit brought by the employees. Therefore, the basis for Sun's demand that the settlement provide no funds to sue Sun had evaporated, making a different settlement possible. Also, the claim that the fraudulent conveyance suit had no value failed in light of the fact that the settlement provided for a payment of $3.7 million. The employees were injured because the settlement eliminated a distribution to them based upon their priority, and they also lost the opportunity to bring their own suit which appeared to have a $3.7 million value to the respondents. The employees, therefore, had standing to prosecute the appeal. *Id.*

The Violation of the Code's Priority Scheme

The Court noted that there were three methods to resolve a Chapter 11 case: a confirmed plan; a conversion to a Chapter 7 liquidation proceeding; or dismissal of the case. *Id.* at *4. A Chapter 11 plan and a liquidation under Chapter 7 must comply with the Code's rules regarding priority of distributions which underpins business bankruptcy law. On the other hand, a dismissal aims to return the parties to the prepetition status quo. *Id.* at *4. Where restoration to the prepetition status

> *"Can a bankruptcy court approve a structured dismissal that provides for distributions that do not follow ordinary priority rules without the affected creditors' consent? No."*

quo is not possible, Code section 349(b) allows some alteration of the restorative consequences of dismissal "for cause." *Id.* at *5. The priority system, however, is fundamental to the Code's operation. Regarding priority-skipping structured dismissals, the Court said ". . . [w]e 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. We can find nothing that evinces this intent." *Id.* at *10.

Moreover, the Court noted that while during the Chapter 11 case bankruptcy courts routinely enter certain priority-skipping orders, such as first-day wage orders allowing the payment of prepetition wages, critical vendor orders to pay essential suppliers, and rollups which allow lenders who continue to finance the debtor post-petition to be paid on their prepetition claims, these departures facilitate a successful reorganisation and benefit all creditors. *Id.* at *12. By contrast, the Code does not authorise ". . . nonconsensual departures from the ordinary priority rules in the context of a dismissal—which is a *final* distribution of estate value—and in the absence of any further unresolved bankruptcy issues." *Id.*

The Court acknowledged that the Third Circuit did not approve all priority-violating structured dismissals, but only dismissals in those rare circumstances for which there were sufficient reasons. *Id.* at *13. However, allowing courts to define "rare circumstances" will result in uncertainty, "[A]nd uncertainty will lead to similar claims being made in many, not just a few, cases." *Id.* The Court concluded that ". . . Congress did not authorise a "rare case" exception." *Id.* at *21.

Conclusion

The Court summarised its holding as follows: "Can a bankruptcy court approve a structured dismissal that provides for distributions that do not follow ordinary priority rules without the affected creditors' consent? Our simple answer is no." *Id.* at *10. The Court's decision sounds a death knell for a tactic which was becoming increasingly popular as a means to resolve disputes and conclude a Chapter 11 case without complying with the Code's requisites regarding the priority of distribution to creditors.

Peter C. Blain is a shareholder and the chair of Reinhart Boerner Van Deuren s.c.'s Business Reorganisation Practice Group. He also served as vice president and director of the firm from 1992 to 2005. Mr. Blain regularly represents financial institutions, creditors, debtors, creditor's committees, trustees and others in bankruptcy proceedings, receiverships, and workouts. A fellow in the American College of Bankruptcy, Mr. Blain has been listed in Woodward and White's Best Lawyers in America continuously since 1987, and was selected as Milwaukee's Bankruptcy and Creditor's Rights Lawyer of the Year in 2011. Since 2005, Mr. Blain has been selected as a Wisconsin Super Lawyer by Law and Politics, and has been recognised as one of the top fifty super lawyers in the state.

Mr. Blain is a graduate of Georgetown University Law Center and Wisconsin State University at Stevens Point. Prior to law school, Mr. Blain served for two years as a U.S. Army lieutenant. While attending law school he worked in the Office of the Controller at the Veteran's Administration in Washington, D.C.a