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In a 6-2 decision in Czyzewski v. Jevic Holding Corp. ("Jevic"), the Supreme Court put an end to the increasingly popular practice in the bankruptcy world known as "structured dismissals," at least on a non-consensual basis. A "structured dismissal" typically occurs following a sale of all or substantially all of a Chapter 11 debtor's assets during a bankruptcy case. Rather than proposing and confirming a Chapter 11 plan after the sale, the debtor seeks to dismiss the Chapter 11 case conditioned on certain elements agreed to in advance by stakeholders in the case, typically the debtor, the secured lenders, and the creditors' committee.

Structured dismissals are proposed because the debtor does not have sufficient cash (and the secured creditor refuses to fund the additional cash) to pay certain categories of claims, such as tax, employee wage, and administrative expense claims. These senior classes of claims would have to be paid in full in order to confirm a Chapter 11 plan, and general unsecured creditors cannot, under the Bankruptcy Code's distribution scheme, receive any distribution unless the priority and administrative classes of claims are paid in full.

In the Jevic bankruptcy case, the creditors' committee sued Sun Capital Partners and CIT Group, arguing that a pre-bankruptcy leveraged buyout hastened Jevic's bankruptcy by saddling Jevic with debts that it could not service. The debtor, creditors' committee, Sun, and CIT ultimately reached a "structured dismissal" settlement whereby

i. the creditors' committee dismissed its lawsuit,

ii. Sun and CIT obtained releases,

iii. CIT agreed to pay $2 million to fund the creditors' committee legal fees and expenses,

iv. $1.7 million of cash in which Sun held a lien would be assigned to a trust to be used to pay taxes and other administrative expenses,

v. the remaining funds would be distributed to low-priority general unsecured creditors, and

vi. the Chapter 11 case would be dismissed without the filing of a Chapter 11 plan.

However, the structured dismissal did not provide for any distributions to a class of former Jevic truck drivers (the "WARN Claimants") who held $8.3 million in priority wage claims (relating to pre-bankruptcy state and federal WARN Act violations) that, absent consent, were entitled to be paid ahead of general unsecured creditors according to the payment priority provisions under either Chapter 7 or Chapter 11 of the Bankruptcy Code.

The Bankruptcy Court approved the structured dismissal, including its priority-skipping payment provisions, over the objections of the WARN Claimants and the United States Trustee. In essence, the Bankruptcy Court ruled that such dismissals are justified in exceptional circumstances where a better alternative is not available. The District Court and Third Circuit Court of Appeals affirmed, with the Third Circuit cautioning that priority-skipping structured dismissals should be approved only in "rare" circumstances.

On appeal, the Supreme Court reversed. The Court ruled that the "rare case" exception would open the floodgates and turn the exception "into a more general rule," and held that a bankruptcy court cannot "approve a structured dismissal that provides for distributions that do not follow ordinary priority rules without the affected creditors' consent." The Supreme Court explained that while the Bankruptcy Code grants a court the power to dismiss a Chapter 11 case, it does not authorize -- even in a rare case -- the approval of final and end-of-case distributions that deviate from the Bankruptcy Code's priority scheme.

On appeal, the Supreme Court reversed... and held that a bankruptcy court cannot approve a structured dismissal that provides for distributions that do not follow ordinary priority rules without the affected creditors' consent."

Critically for purposes of trade creditors, employees, and lenders, the Supreme Court distinguished priority-violating structured dismissals -- which are now disallowed -- from other interim types of distributions in Chapter 11 cases that potentially deviate from the priority rules but occur earlier on in Chapter 11 cases and that "seem[ ] significant."
potentially deviate from the priority rules but occur earlier on in Chapter 11 cases and that "serve[s] significant Code-related objectives." Specifically, the Supreme Court noted (without expressly ruling) that the following types of orders, under the appropriate circumstances, can be approved:

- "critical vendor" orders that allow payment of essential suppliers'/trade vendors' prepetition unsecured claims;
- "first-day" wage orders that allow payment of employees' prepetition wages;
- "roll-ups" that allow lenders that continue financing the debtor to be paid first on their prepetition claims; and
- interim distributions of settlement proceeds to fund a litigation trust that would press claims on the estate's behalf, but in a situation where the Chapter 11 case remains pending.

While bankruptcy practitioners were nervous that the Supreme Court's Jevic decision might put an end to all types of pre-Chapter 11 plan distributions that violate the priority scheme embodied in the Bankruptcy Code, trade creditors, employees, and lenders can breathe a sigh of relief because Jevic acknowledged that certain types of payments that are often approved by the bankruptcy court at the outset of a Chapter 11 case are not prohibited under the appropriate circumstances. Moreover, fully consensual structured dismissals are still permitted. However, lacking a fully consensual structured dismissal, the Jevic decision will leave debtors (and lenders funding a Chapter 11 case) with the choice of having to fund and confirm a Chapter 11 plan, dismiss the Chapter 11 case (without a structured dismissal order), or convert the Chapter 11 case to a Chapter 7 bankruptcy.

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