# Structured Dismissals in Chapter 11 Post-*Jevic*


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Traditionally, there are three ways a chapter 11 business reorganization bankruptcy case concludes: (1) confirmation of a chapter 11 reorganization plan; (2) conversion to a chapter 7 liquidation case; or (3) unconditional dismissal of the chapter 11 bankruptcy case. However, a fourth, hybrid option known as a "structured dismissal" has become an increasingly popular option in an effort to minimize costs and maximize creditor recovery. Meanwhile, questions have arisen regarding when structured dismissals are appropriate, what can be accomplished through a structured dismissal, and whether a structured dismissal is authorized by the Bankruptcy Code at all. In March 2017, the United States Supreme Court provided some guidance regarding these complicated questions in *Czyzewski v. Jevic Holding Corporation*, 137 S.Ct. 973 (2017) ("*Jevic*")—specifically, whether the provisions of a structured dismissal can circumvent the distribution priority scheme of the Bankruptcy Code.[2] This article provides an overview of structured dismissals and their general components, the common objections to such dismissals, and the Supreme Court's recent decision in *Jevic*.

### I. What is a Structured Dismissal?

A successful business reorganization case under chapter 11 of the Bankruptcy Code typically concludes with a plan of reorganization being confirmed and consummated. Over the years, however, bankruptcy practitioners have developed various methods and strategies to bypass the potentially lengthy and costly chapter 11 plan confirmation process, especially in cases where the debtor does not have sufficient assets to pay the administrative costs of the bankruptcy case or fund the chapter 11 plan confirmation process. One of these methods is a structured dismissal of the chapter 11 bankruptcy case, which usually occurs after either the sale of substantially all of the debtor's assets under § 363 and/or a global settlement under Rule 9019(a) of the Federal Rules of Bankruptcy Procedure.[3] A structured dismissal occurs where certain stakeholders, including the debtor, agree to dismiss a chapter 11 case subject to various conditions designed to reduce the costs and time of winding down the bankruptcy case and maximize the funds available for distribution to creditors.[4] Common provisions utilized in a structured dismissal include:

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[2] 11 U.S.C. §§ 101, *et seq.* Hereafter, all code sections refer to the Bankruptcy Code unless otherwise noted.

[3] FED. R. BANKR. P. 9019(a) governs settlements in bankruptcy and provides that a court may approve a compromise or settlement upon a motion by a trustee or debtor-in-possession.

[4] Specifically, a structured dismissal is often more efficient and less expensive than either an unconditional dismissal or a conversion and subsequent liquidation under chapter 7. Particularly, an unconditional dismissal does not come with "bells and whistles," that can be included in a structured dismissal order, and a conversion to chapter 7 requires the appointment of a chapter 7 trustee who will incur costs in investigating and prosecuting claims, liquidating assets, and distributing funds to creditors.

- An expedited and cost-effective procedure to resolve claim disputes and distribute funds to creditors;
- Release and exculpation provisions traditionally approved as part of a confirmed chapter 11 plan;
- Carve-outs and "gifting" provisions, in which a senior secured lender carves out a portion of its collateral, usually from sale proceeds, as a gift to unsecured creditors in exchange for their consent to the parameters of the structured dismissal; and
- Terms providing that prior orders of the bankruptcy court remain effective post-dismissal and that the bankruptcy court retains jurisdiction to implement the structured dismissal order and adjudicate certain disputes and matters.[5]

Although the concept of a structured dismissal is not expressly authorized in the Bankruptcy Code, practitioners generally rely on some combination of §§ 1112(b), 305(a)(1), and 105(a) for authority in seeking such a remedy. Section 1112(b)(1) provides, in part, that a court shall convert a chapter 11 case to a chapter 7 liquidation case or dismiss the case, whichever is in the best interests of creditors and the estate, for cause.[6] Section 1112(b)(4), in turn, provides a non-exhaustive list of circumstances that constitute "cause" under § 1112(b)(1).[7] Practitioners commonly argue that "cause" exists under § 1112(b)(1) to warrant a structured dismissal because there is a "substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation" and an "inability to effectuate substantial consummation of a confirmed plan."[8] Further, it is argued that the structured dismissal is in the best interests of creditors and estate because it is more efficient and cost-effective than converting to and administering a case under chapter 7 and the enhanced dismissal provisions in the dismissal order are better for the creditors and estate than an unconditional dismissal.[9] Further § 305(a)(1) provides, in part, that a court may dismiss a bankruptcy case under any chapter if "the interests of creditors and the debtor would be better served by such dismissal[,]" and § 105(a) provides that a court "may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions" of the Bankruptcy Code.[10]

The utilization of the aforementioned provisions, together with the opportunity to short-circuit the lengthy and expensive plan confirmation process, have made structured dismissals a popular exit strategy from chapter 11 cases.

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[5] Norman L. Pernick and G. David Dean, *Structured Chapter 11 Dismissals: A Viable and Growing Alternative after Asset Sales*, 29 Am. Bankr. Inst. J. 1 (June 2010).

[6] 11 U.S.C. § 1112(b)(1).

[7] *See* 11 U.S.C. § 1112(b)(4)(A)-(P).

[8] *See* 11 U.S.C. § 1112(b)(4)(A) & (M); Pernick, *supra* note 5 at 56.

[9] Pernick, *supra* note 5 at 56.

[10] Sections 305(a)(1) and 105(a) are not without their limitations. Section 305(a)(1) is recognized as an extraordinary remedy, and § 105(a) "does not allow a bankruptcy court to override explicit mandates of other sections of the Bankruptcy Code. *See In re Monitor Single Lift I Ltd.*, 381 B.R. 455, 463 (Bankr. S.D.N.Y. 2008) (discussing the standard under § 305(a)(1)) ; 2 COLLIER ON BANKRUPTCY ¶ 105.01[2] (discussing the utilization of § 105).

## II. Common Objections to Structured Dismissals

Although structured dismissals are generally utilized with the consent of the major stakeholders in a bankruptcy case, several concerns regarding the legality of structured dismissals exist. Indeed, the United States Trustee's Office commonly objects to structured dismissals on several grounds, including that a structured dismissal may:

- Distribute assets in violation of the Bankruptcy Code's priority scheme;[11]
- Include improper or overbroad release and exculpation provisions;[12]
- Violate § 349(b)'s requirements that a dismissal of a bankruptcy case restores the prepetition *status quo ante* of the debtor and reinstates the remedies of creditors under applicable non-bankruptcy law;[13] and
- Constitute a *sub rosa* chapter 11 plan by seeking to circumvent plan confirmation requirements and creditor protections.[14]

This first concern, whether a structured dismissal is permissible if its conditions violate the priority scheme of the Bankruptcy Code, was the issue recently addressed by the U.S. Supreme Court in *Jevic*.

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[11] The Bankruptcy Code establishes a general system of priority that determines the order in which creditors receive distribution of a bankruptcy estate's property. Generally, secured creditors are entitled to receive the proceeds of the collateral securing their debt. *See* 11 U.S.C. § 725. Then, certain priority claimants, which, relevant to *Jevic*, include creditors who are owed taxes or wages, are paid next. *See* 11 U.S.C. §§ 507 & 726(a)(1). Once those claimants are paid, general unsecured creditors are entitled to a distribution. *See* 11 U.S.C. § 726(a)(2). Further, in chapter 11 cases, a bankruptcy court will only confirm a plan over the objections of a dissenting class of unsecured creditors if the plan provides that they will be paid in full or no holder of any claim or interest that is junior to the dissenting class will retain any property under the plan. *See* 11 U.S.C. 1129(b)(2)(B)(i) & (ii). This is known as the "absolute priority rule."

[12] Specifically, an objector may contend that any debtor releases contravene §§ 727(a) and 1141(d)(3), which bar "non-individual" debtor discharges in a liquidating context. *See* Nan Roberts Eitel, T. Patrick Tinker & Lisa L. Lamber, *Structured Dismissals, or Cases Dismissed Outside of Code's Structure?*, 30 Am. Bankr. Inst. J. 20, at 20-21 (Mar. 2011). As for non-debtor releases, which are recognized by the Eleventh Circuit Court of Appeals in "unusual cases," an objector may argue such a release is improper because a creditor does not have the ability to assess and negotiate releases without the chapter 11 plan confirmation safeguards of debtor disclosure statements and plan voting. *See id.*; *SE Prop. Holdings, LLC v. Seaside Eng'g & Surveying, Inc. (In re Seaside Eng'g & Surveying, Inc.)*, 780 F.3d 1075-81 (11th Cir. 2015) (recognizing the circuit split on the ability of a bankruptcy court to issue a non-debtor release before siding with the majority of courts in holding that such authority exists in unusual cases where the release "is necessary for the success of the reorganization" and "fair and equitable under all of the facts and circumstances").

[13] The purpose of § 349(b), which governs the effect of dismissal, is "to undo the bankruptcy case, as far as practicable, and to restore all property rights to the position in which they were found at the commencement of the case." H.R. REP. NO. 95-595, at 338 (1977), *reprinted in* 1978 U.S.C.C.A.N.

[14] Namely, a structured dismissal may be viewed as an attempt to "'short circuit . . . the Code's carefully crafted scheme for creditor enfranchisement,' including 'the safeguards of disclosure, voting, acceptance, and confirmation.'" Eitel, *supra* note 14 (footnotes omitted) (quoting another source).

## III. *Czyzewski v. Jevic Holding Corp*

Jevic Transportation, Inc. ("Jevic") was a New Jersey-based trucking company acquired by Sun Capital Partners ("Sun Capital") in a leveraged buyout financed by CIT Group.[15] Two years after the buyout, Jevic filed for relief under chapter 11 of the Bankruptcy Code.[16] At the time of filing, Jevic owed more than $50 million to Sun Capital and CIT, both of which were secured by virtue of the leveraged buyout, and more than $20 million to taxing authorities and general unsecured creditors.[17] Jevic's bankruptcy case spawned two lawsuits. First, a class action suit was filed by a group of terminated Jevic truck driver employees against Jevic and Sun Capital claiming they were not given sufficient notice of their termination under state and federal Worker Adjustment and Retraining Notification ("WARN") Acts.[18] Although the suit against Sun Capital was ultimately unsuccessful, the truck drivers obtained summary judgment against Jevic in the amount of $12.4 million, $8.3 million of which constituted a priority wage claim under § 507(a)(4).[19] Second, the court-authorized committee representing Jevic's unsecured creditors sued Sun Capital and CIT, asserting, in part, the transfers made and obligations incurred during the leveraged buyout were avoidable as preferences and fraudulent transfers.[20] At this point, the only two remaining assets of Jevic's bankruptcy estate were $1.7 million in cash and the fraudulent conveyance action itself.[21] Sun Capital, CIT, Jevic, and the committee reached a settlement agreement of this suit, which provided, in relevant part, that (1) the Bankruptcy Court would dismiss the fraudulent conveyance suit with prejudice; (2) Sun Capital would assign its lien on Jevic's remaining $1.7 million in cash to a trust, which would first pay taxes and administrative expenses and then be distributed on a *pro rata* basis to general unsecured creditors; and (3) Jevic's bankruptcy case would be dismissed.[22] Importantly, the settlement would require the $1.7 million to bypass the truck drivers, whose $8.3 million wage claim against the Jevic estate had priority over general unsecured creditor claims under the Bankruptcy Code.[23]

Sun Capital, CIT, Jevic, and the committee sought the Bankruptcy Court's approval of the settlement and dismissal, and the Jevic truck drivers and U.S. Trustee objected, arguing that the settlement's distribution plan violated the Bankruptcy Code's priority scheme.[24] The Bankruptcy Court

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[15] *Jevic*, 137 S.Ct. at 980.

[16] *Id.*

[17] *Id.*

[18] *Id.*

[19] *Id.* at 980-81.

[20] *Id.* at 981.

[21] *Id.*

[22] *Id.*

[23] *Id.* Sun Capital's counsel explained to the bankruptcy court that Sun Capital did not want funds going to the Jevic truck drivers because it did not want to fund the WARN act litigation against itself. *Id.*

[24] *Id.*

recognized that the settlement's distribution procedure did not follow the Bankruptcy Code's priority rules but held that this was not fatal to approval because the distribution would occur pursuant to a structured dismissal rather than a confirmed chapter 11 plan.[25] Further, the court held that the "dire circumstances" regarding the estate and creditors warranted the relief sought because there was no realistic prospect of a confirmable chapter 11 plan, a meaningful distribution of funds beyond the secured creditors, or an availability of funds to administer a chapter 7 liquidation case properly.[26] The U.S. District Court for the District of Delaware and the Third Circuit Court of Appeals each affirmed the decision to approve the settlement and dismissal.[27] Specifically, the Third Circuit held that in rare instances, such as the present case, structured dismissals do not need to strictly adhere to the Bankruptcy Code's priority scheme.[28] The Supreme Court subsequently granted the truck drivers' petition for certiorari.[29]

The Supreme Court reversed and remanded the case holding that a bankruptcy court cannot approve a structured dismissal that provides for a nonconsensual distribution of estate assets in violation of the Bankruptcy Code's priority scheme.[30] Specifically the Court lamented that the Bankruptcy Code's priority scheme "constitutes a basic underpinning of business bankruptcy law" and is "fundamental to the Bankruptcy Code's operation."[31] Given this statutory context, the Court found that if Congress intended to allow structured dismissals to serve as "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," it would have expressly done so.[32] The Court did concede that § 349(b) provides that a bankruptcy court may, for cause, limit or alter the restorative effects of dismissal, but the Court found that this provision was designed to give courts the ability "to protect rights acquired in reliance on the bankruptcy case" and that the word "cause" is too weak to bear the power of conditioning dismissal on a priority-altering final distribution of estate assets.[33] The Court similarly rejected the Third Circuit's "rare case" qualification in its decision that nonconsensual priority-violating structured dismissals are permissible because it is not consistent with the protections granted by the Bankruptcy Code and the exception would

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[25] *Id.* at 981-82.

[26] *Id.* at 982.

[27] *See Czyzewski v. Jevic Holding Corp. (In re Jevic Holding Corp.)*, Bank. No. 08-11006(BLS), 2014 WL 268613 (D. Del. Jan. 24, 2014); *Official Comm. of Unsecured Creditors of Jevic Holding Corp. v. CIT Group/Business Credit Inc. (In re Jevic Holding Corp.)*, 787 F.3d 173 (3d Cir. 2015).

[28] *Official Comm. of Unsecured Creditors of Jevic Holding Corp.*, 787 F.3d at 180.

[29] *Czyzewski*, 137 S.Ct. at 982.

[30] *Id.* at 983.

[31] *Id.* at 983-84.

[32] *Id.* at 984.

[33] *Id.* 984-85.

risk becoming the general rule.[34] In addition, the Court explicitly stated that it does not express any view "about the legality of structured dismissals in general."[35]

## IV. Jevic's Impact on Structured Dismissals and Beyond

First and foremost, the Supreme Court in *Jevic* made clear that a structured dismissal cannot include conditions deviating from the Bankruptcy Code's priority scheme without consent.[36] Notably, the Court narrowed its holding by stating that it does not express any opinion about the legality of structured dismissals in general.[37] Thus, as for *Jevic*'s impact on structured dismissals, parties seeking to exit a chapter 11 case with a structured dismissal must ensure that either any distributions comply with the absolute priority rule or the parties obtain the consent of every creditor that is excluded from distribution in contravention of the Bankruptcy Code's priority scheme.[38]

Overall, the result in *Jevic* was not particularly surprising to bankruptcy practitioners. Instead, the uncertainty leading up to the Court's decision focused on the potential scope of the decision and its impact on other common chapter 11 practices that include priority deviations.[39] In determining whether the terms of a structured dismissal could deviate from the Bankruptcy Code's priority procedure, the Court heavily distinguished between interim orders entered in conjunction with the administration of a bankruptcy case from final, dispositive orders, such as the structured dismissal at issue in *Jevic*.[40] Specifically, the Court contrasted a structured dismissal with common chapter 11 first-day practices that seemingly violate ordinary priority rules, including wage orders that enable payment of employees' prepetition wages, "critical vendor" orders that allow payment of essential suppliers' prepetition invoices, and "roll-ups" that generally allow lenders who continue financing the debtor to be paid first on their prepetition claims.[41] The Court found that with respect to these actions, the priority-violating distributions serve "significant Code-related objectives" and "enable a successful reorganization and make even the disfavored creditors better off."[42] To the contrary, the priority-violating distribution in a structured dismissal is attached to a final disposition and does not (a) "preserve the debtor as a going concern"; (b) "make the disfavored creditors better off"; (c) "promote the possibility of a confirmable plan"; (d) help to

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[34] *Id*. 986-87.

[35] *Id.* at 985.

[36] *Id.* at 983-87.

[37] *Id.* at 985.

[38] *Id.* at 983-87.

[39] Daniel Bussel, *Opinion Analysis: Bankruptcy priority rules may not be evaded in Chapter 11 structured dismissals*, SCOTUSBLOG (Mar. 23, 2017, 6:38 AM), http://scotusblog.com/2017/03/opinion-analysis -bankrutpcy-priority-rules-may-not-be-evaded-chapter-11-structured-dismissals/.

[40] *Czyzewski*, 137 S.Ct. at 985-86.

[41] *Id.*

[42] *Id.*

restore the *status quo ante*; or (e) protect reliance interests.[43] For this reason, the Supreme Court likened the distributions at issue in *Jevic* to a *sub rosa* plan.[44] By virtue of this distinction, the Supreme Court has provided bankruptcy practitioners guidance on their ability to construct priority-deviating procedures in a chapter 11 bankruptcy case. Namely, such procedures are proper if the associated distributions serve "significant Code-related objectives," such as preserving the debtor as a going concern, making the disfavored creditors better off, promoting the possibility of a confirmable plan, helping to restore the *status quo ante*; or protecting reliance interests. Consequently, despite the Supreme Court's effort to narrow its opinion in *Jevic*, its analysis will impact chapter 11 practice beyond the utilization of structured dismissals.

[43] *Id.*

[44] *Id.* at 986.