Yes, Virginia, there is a Code Priority Scheme: Supreme Court Strikes Down Structured Dismissals in Jevic

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A potential threat to the Code's priority scheme is the allowance of "structured dismissals," which include a settlement as part of the dismissal of the chapter 11 case that would distribute estate assets in a manner that contravenes the Code's priority rules. Such priority-altering distributions could not be approved pursuant to a confirmed chapter 11 plan absent the consent of the class that is adversely affected, because of the absolute priority rule (§§ 1129(a)(8), 1129(b)), nor would they be possible if the chapter 11 case were converted to a chapter 7 liquidation, because of the Code's strict distributional priority rules (§ 726). If such structured dismissals were permitted, a debtor and collaborating creditors effectively could do an end-run around the absolute priority rule by exiting chapter 11 via a "dismissal," before the confirmation cram-down rules are formally applied, but with final, binding distributions made as part of the "structured" dismissal in derogation of absolute priority. In an important 2017 decision, the Supreme Court in *Czyzewski v. Jevic Holding Corp.* held that "[a] distribution scheme ordered in connection with the dismissal of a Chapter 11 case cannot, without the consent of the affected parties, deviate from the basic priority rules that apply under the primary mechanisms the Code establishes for final distribution of estate value in business bankruptcies."[1] Importantly, the Court, with Justice Breyer writing the majority opinion, emphasized that "a bankruptcy court does not have such a power."[2]

The Supreme Court reversed the Third Circuit, which had upheld the structured dismissal.[3] The settlement and structured dismissal approved by the Third Circuit would have altered the Code's priority scheme by providing for the payment of legal fees, administrative expenses, and taxes, as well as a pro rata distribution of the remaining balance of the estate to general unsecured creditors, but providing nothing for certain employees' wage claims entitled to fourth priority under § 507(a)(4).[4]

In *Jevic*, the debtor, a trucking company, had been taken over by Sun Capital Partners in a leveraged buyout in 2006 with money borrowed from CIT Group, but soon failed; it ceased operations, laid off employees, and filed chapter 11 by 2008.[5] The laid-off truck drivers filed a lawsuit against Jevic and Sun alleging violations of WARN Acts and seeking a claim for lost wages, and the Committee of Unsecured Creditors brought fraudulent conveyance claims against Sun and CIT relating to the leveraged buyout.[6] The bankruptcy court granted the truck drivers summary judgment against Jevic in the amount of $12.4 million, of which $8.3 million would qualify as a priority wage claim under § 507(a)(4).

By 2012, with the bankruptcy estate's only remaining assets being $1.7 million in cash (subject to a lien in favor of Sun) and the fraudulent conveyance action against Sun and CIT, a meeting to negotiate a settlement convened.[7] The settlement reached and approved, but which excluded the contentious drivers, provided for: (1) releases of claims and dismissal of the fraudulent conveyance actions against Sun and CIT; (2) payment of $2 million by CIT into an account for fees and administrative expenses; (3) release of the lien on the $1.7 million by Sun and transfer of the cash to

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[1] Czyzewski v. Jevic Holding Corp., - S.Ct. -, 2017 WL 1066259, at slip op. *2 (U.S. Mar. 22, 2017).

[2] Id.

[3] Official Committee of Unsecured Creditors v. CIT Group/Business Credit Inc. (In re Jevic Holding Corp.), 787 F.3d 173 (3d. Cir. 2015), reversed, - S.Ct. -, 2017 WL 1066259 (U.S. Mar. 22, 2017).

[4] *Jevic*, 2017 WL 1066259, at slip op *7.

[5] Id. at *5.

[6] Id. at *6-*7.

[7] Id at *7.

a trust to pay out administrative and tax creditors first, with the remaining funds to be distributed, pro rata, to the general unsecured creditors, but bypassing the higher-priority drivers' claims; and (4) the chapter 11 case to be dismissed.[8] It appears the drivers were not provided for because a settlement of their claim could not be agreed upon and the other parties did not want to fund the drivers' then on-going WARN Act lawsuit against Sun (which was subsequently resolved in favor of Sun).[9] The Supreme Court emphasized that "[t]he essential point is that, regardless of the reason, the proposed settlement called for a structured dismissal that provided for distributions that did not follow ordinary priority rules."[10]

The drivers and the United States Trustee opposed the settlement, primarily because it violated the Code's priority scheme by skipping over the drivers, who had a fourth priority under § 507(a)(4), while nevertheless providing for the distribution of estate assets to lower-priority general unsecured creditors.[11] However, both the Bankruptcy Court and the District Court for the District of Delaware approved the settlement and structured dismissal.[12] The Third Circuit affirmed, holding that "absent a showing that a structured dismissal has been contrived to evade the procedural protections . . . of the plan confirmation . . . processes, a bankruptcy court had discretion to order such a disposition,"[13] but "only if they have specific and credible grounds to justify the deviation."[14] The Third Circuit majority determined that the absolute priority rule does *not* apply outside of the plan confirmation setting.[15] That court agreed with the assumptions that the only possible settlement was one that violated priority, and that but for this priority-violating settlement, the fraudulent-conveyance claim would have no value and no one other than Sun or CIT would get anything. Better, the circuit court believed, for at least *some* unsecured creditors to get paid something (even if the drivers did not share in that fortunate bounty), which they would not have but for the settlement, and regardless, the drivers could not really complain, because they would have gotten nothing anyway.[16]

The Supreme Court flatly rejected the circuit court's instinct that, in effect, half a loaf is better than none, even if just for some chosen few, and that those who would have starved anyway cannot complain that they are still starving while others feed at the trough. That flawed reasoning is essentially identical to the argument rejected a century ago by the Supreme Court in *Northern Pacific Railway Co. v. Boyd*.[17] Remaining faithful to the "fixed principle" of absolute priority is the only sure safeguard to shenanigans such as went on in *Jevic,* where the uncooperative drivers were the *only* group shunned from the distributional table, simply because they wouldn't "play nice" and go along. To sidestep and bless the blatantly redistributive scheme because it was not done technically pursuant to a confirmed plan does not change the fact that the redistribution was effected by the federal bankruptcy court in a final order in a chapter 11 case.[18]

As Justice Breyer cogently framed the critical question: "Can a bankruptcy court approve a structured dismissal that provides for distributions that do not follow ordinary priority rules without the affected creditors' consent?," to which he squarely stated that "[o]ur simple answer to this complicated question is 'no.'"[19] In so holding, the Supreme Court embraced the "fundamental" importance of the priority system governing distributions,[20] and insisted that the Bankruptcy Code be

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[8] Id.

[9] Id. at *7-*8.

[10] Id. at *8.

[11] Id. at *8.

[12] Id. at *8-*9.

[13] 787 F.3d at 182.

[14] Id. at 184 (internal citations omitted).

[15] Id. at 184.

[16] Id. at 185–86.

[17] 228 U.S. 482 (1913).

[18] The ABI Study Commission also concluded that structured dismissals should not be permitted. See 2014 ABI Commission Report, at 269–73.

[19] *Jevic*, 2017 WL 1066259, slip op. at *11.

[20] Id. at *12.

read holistically in a manner that that furthers its object and policy.[21] That overarching object and policy plainly provides, the Court believed, that end-of-case final distributions must comply with the Code's carefully crafted priority rules. Allowing a structured dismissal "to make nonconsensual priority-violating distributions of estate value"[22] would undermine the Code's holistic scheme of priority. The Court declined to read the general reference on the effects of a dismissal in § 349(b) to the court's power to "order[] otherwise" "for cause" so capaciously as to authorize a complete rewriting of the extensive and specific priority rules.[23]

The Court declined to countenance priority-violating structured dismissals on the weak excuse that they only should be approved in "rare" cases.[24] To begin with, the Court found "dubious" the particular assumptions undergirding the "rarity" approval in the lower courts below, and indeed rejected a "no standing" argument premised on those assumptions by finding that the truck drivers had demonstrated potential harm.[25] The Court found that the fraudulent conveyance claim might well have had value—some of which would have gone to the truck drivers—even without the settlement. Why else would Sun and CIT have paid $3.7 million to make it go away? Importantly, and more broadly, the Court's ruling and reasoning effectively reject the commonly-invoked premise that Code-violating orders must grudgingly be accepted because the parties just won't agree to anything else. Finding that the bankruptcy court lacks the *power* to approve a structured dismissal effectively calls the parties' bluff. Furthermore, Justice Breyer astutely noted that the supposed "rarity" of such cases likely would give way to a much more commonplace usage.[26] And that, he observed, would lead to serious consequences: weakening protections for certain classes of creditors; recasting bargaining power; making settlement more difficult; and enhancing the risk of collusion, where senior and junior creditors team up to squeeze out mid-level claimants[27]—just as happened here, and a century ago in *Boyd*. The Court also suggested a separation of powers concern, noting that the courts cannot rewrite the statute that Congress wrote, even where they believe that doing so would make creditors better off.[28]

In its reasoning supporting its holding, the Court distinguished *interim* distributions that might deviate from a strict adherence to the Code's priority scheme, such as critical vendor orders and first-day wage orders. Such orders further "significant Code-related objectives," such as promoting the chances of an effective reorganization and increasing the value of the estate for all creditors.[29] This dictum thus should allay concerns that the Court's strong fealty to the text of the Code that Congress wrote might undermine the legitimacy of such interim orders.

But at the same time, the Court then distinguished *final* distributions of estate value, and found no room for evasion of Code priority rules there, no matter what *form* the final distribution might take, even if cast in the form of a sale or a dismissal.[30] Notably, the Court cited the *Chrysler* § 363 asset sale, which was deemed proper only because it did demonstrate proper solicitude for the established priorities between creditors, as contrasted with the *Braniff Airways* case in which the "sale" was rejected as effectively a *sub rosa* plan.[31] The Court's hard-line insistence on complying with statutory priorities in a final distribution of estate value is extremely significant for chapter 11 practice. Had the Court held otherwise, parties would have had an open invitation to do an end-run around the Code's priority scheme and procedural safeguards simply by casting the final deal as a "structured

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[21] Id. at *13-*14.
[22] Id. at *13.
[23] Id. at *13-*14.
[24] Id. at *16-*18.
[25] Id. at *9-*11.
[26] Id. at *17.
[27] Id. at *17-*18.
[28] Id. at *18.
[29] Id. at *15.
[30] Id. at *16.
[31] Id.

dismissal." Now parties seeking to negotiate over reorganization value actually have to play by the long-established rules of absolute priority.