



# Justices Avoid Upending Ch. 11 Creditor Payment Practices

By **Alex Wolf**

Law360, New York (March 23, 2017, 10:21 PM EDT) -- With its ruling that so-called structured dismissals to end Chapter 11 cases cannot sidestep the Bankruptcy Code's creditor priority scheme, the U.S. Supreme Court avoided going so far as to prohibit deviation from the scheme at any time during a case, instead making a carefully tailored decision that doesn't disturb routine practices, experts say.

A number of bankruptcy attorneys, including those who represented parties on the losing side of the **Supreme Court's decision** in *Czyzewski et al. v. Jevic Holding Corp. et al.*, were relieved Wednesday after the justices ruled that courts cannot authorize a distribution of Chapter 11 estate assets in violation of creditor hierarchy as part of a structured dismissal without proper consent.

The reason, evidently, is that the court wanted to avoid a broader conclusion that there can never be a deviation from the U.S. Bankruptcy Code's absolute priority rule governing the order in which classes of creditors are paid in Chapter 11, a proposition explored in appellate briefing and at oral arguments.

A broader decision could have effectively eliminated what are known as "first-day motions" that allow a debtor to pay critical vendors, employee wages, taxes and other expenses before paying secured or higher-priority creditors, according to experts.

"If they had issued a broader opinion, I think it could have really wreaked havoc in day-to-day bankruptcy practice and, fortunately,

that didn't happen," said Rob Feinstein, a Pachulski Stang Ziehl & Jones attorney who represents a group of unsecured Jevic creditors. "We wanted to win our own case, but if we lost, we didn't want to lose on a basis that would break bankruptcy."

Feinstein and other attorneys believe Justice Stephen Breyer, who wrote for the six-judge majority, crafted a narrow and carefully worded opinion to say that structured dismissals that provide for distributions that do not follow ordinary priority rules can only be approved with the consent of affected creditors, but that interim payments that serve "Code-related objectives" are fine.

This avoided any holding that would affect the permissibility of more common priority-jumping payments.

"You can certainly say that they went out of their way to say Jevic cannot be cited for the proposition that those are improper, and I think for the vast majority of cases, that is actually going to be the most important language in this decision," said O'Melveny & Myers LLP partner Evan Jones.

The high court's decision overturns a 2012 structured dismissal settlement in Jevic Holding Corp.'s Chapter 11 case that effectively wiped out priority employee claims against the trucking company while paying more junior creditors. The Third Circuit affirmed the dismissal in a 2015 ruling.

At issue was the agreement New Jersey-based Jevic reached with its private equity owner Sun Capital Partners Inc., secured lender CIT Group Inc. and the official unsecured creditors committee. The deal, which awarded \$1.7 million to creditors with general unsecured claims, left no recovery for truckers who had an \$8.3 million priority claim for violations of the Worker Adjustment and Retraining Notification Act.

The **appeal focused** on the strategy Jevic used to resolve its case. Usually, a bankruptcy case can be resolved in only one of three ways: confirmation of a Chapter 11 plan of reorganization by a bankruptcy judge; a Chapter 7 conversion to liquidate a debtor's assets; or outright dismissal of a bankruptcy case, leaving individual creditors seeking a recovery to fend for themselves.

But a structured dismissal has some hybrid qualities. Under this dismissal method, a court may toss a case while approving certain distributions to creditors, granting third-party releases or holding in place certain transactions undertaken during the Chapter 11 proceedings.

Attorneys for Jevic and the other parties that fought to keep the settlement intact **argued that** while structured dismissal distributions should generally follow the absolute priority rule, it may be permissible to leapfrog a certain group of creditors in "rare circumstances." In the instant case, where there was no possibility of confirming a Chapter 11 plan and no chance for unsecured creditors to recover anything under a liquidation, those rare circumstances were present, they claimed.

The justices disagreed, saying it would be possible for the parties in this case to settle in a way that respects ordinary priorities, but, no matter what, "courts cannot deviate from the strictures of the code, even in 'rare cases.'"

"What struck me the most was the simplistic nature of the opinion," said Randye B. Soref of Polsinelli LLP. "[Justice Breyer] was really careful about ensuring that this isn't read so broadly to apply to other aspects of Chapter 11."

In their dissent, Justices Clarence Thomas and Samuel Alito complained that the question the court answered was narrower than the one it agreed to resolve when it granted certiorari last year.

They said the court was initially tasked with deciding whether a bankruptcy court can authorize a settlement that distributes proceeds in violation of the priority scheme, but the petitioners later recast the question to focus on whether a Chapter 11 case may be terminated by a structured dismissal that breaks from absolute priority.

With the potential to rule more broadly, the court's focus on the specific application of creditor hierarchy in the context of a structured dismissal leaves Chapter 11 mostly undisturbed, according to the experts.

"It was so narrowly tailored that I think they addressed the one issue that they had without causing a lot of collateral damage," said

Gavin/Solmonese LLC turnaround professional Ted Gavin, who several years ago testified in favor of the structured dismissal settlement.

While the parties in Jevic may have some trouble on remand figuring out how to rework distributions, "bankruptcy is full of intelligent practitioners who will put their heads together and come up with a way to accomplish exactly what was accomplished here, but not run afoul of the constraints of the Bankruptcy Code," he added.

The ripples felt from the court's ruling may not even alter how often structured dismissals are used, the experts said. Though they have become more common in recent years, structured dismissals aren't often used to override absolute priority, according to Feinstein, who noted that they still remain a viable way to resolve a Chapter 11 case.

Winston & Strawn LLP bankruptcy litigation practice chair Melanie Gray said that while the ruling will likely cause bankruptcy courts to look more closely at structured dismissals, the immediate impact felt by debtors and practitioners should be minimal.

"I would be surprised if there are many situations out there where either, at the time of dismissal, there's going to be a deviation from the absolute priority or there isn't 100 percent agreement among the constituencies," she said.