In the Land of Structured Dismissals, the Code's Priority Scheme is Still King: The Supreme Court Resolves the Circuit Split in *Czyzewski v. Jevic Holding Corp.*

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On March 22, 2017, in a highly anticipated decision, the Supreme Court of the United States handed down a 6-2 decision[1] in *Czyzewski v. Jevic Holding Corp.*,[2] resolving the circuit split regarding so-called "structured dismissals" that do not follow the Bankruptcy Code's priority scheme. The majority held that a deviation from the Code's priority rules is not permitted in structured dismissals over the objection of affected parties. This narrow holding will necessarily require practitioners to secure the agreement of all parties when proposing a structured dismissal that does not strictly comply with ordinary priority rules and will be a strong weapon in the arsenal of creditors who feel they are not getting their due in such a structured dismissal.

I. Background

Jevic stems from the bankruptcy cases of three affiliated debtors, Jevic Holding Corp., Jevic Transportation, Inc. and Creek Road Properties, LLC (collectively, "Jevic") in the Third Circuit. After Jevic filed their voluntary petitions under Chapter 11 of the Bankruptcy Code, their secured creditors were sued by the unsecured creditors committee under fraudulent conveyance law. Jevic, the committee, and Jevic's senior secured creditors reached a settlement agreement that contemplated, *inter alia*, a settlement of the fraudulent conveyance lawsuit, payment of administrative claims in full, payment to unsecured creditors on a pro rata basis, and the dismissal of Jevic's bankruptcy cases. The problem, however, is that the settlement did not provide for a distribution to truck drivers who had obtained a judgment against Jevic for violations of federal and state Worker Adjustment and Retraining Notification ("WARN") Acts. Under a Chapter 11 plan or in a Chapter 7 liquidation, part of the truck drivers' judgment would have been a priority wage claim entitled to payment ahead of general unsecured creditors.

Over the objection of the truck drivers and the United States Trustee, the bankruptcy court and the United States District Court for the District of Delaware (on appeal) permitted the structured dismissal because it was essentially the better of two bad options. The bankruptcy court noted that the estates were administratively insolvent and that without the proposed settlement, it was unlikely that any constituents outside of Jevic's secured creditors would receive a distribution.

The Third Circuit Court of Appeals agreed with the lower courts.[3] Preliminarily, it determined that structured dismissals are permissible under the Bankruptcy Code, so long as there is not an attempt to "evade the procedural protections and safeguards of the plan confirmation or conversion processes."[4] In rejecting the Fifth Circuit's strict application of the absolute priority rule to settlements,[5] the Third Circuit adopted the Second Circuit's more flexible approach,[6] that the absolute priority rule does not apply to settlements, but the policy behind the rule does. Thus, it emphasized, if a settlement (and, in turn, a settlement that incorporates a structured dismissal) deviates from the priority scheme of Section 507, the parties must have "spe-

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1 Justice Thomas, joined by Justice Alito, dissented, arguing that the original question presented was "whether a bankruptcy court may authorize the distribution of settlement proceeds in a manner that violates the statutory priority scheme," but that once certiorari was granted, Petitioners "switch[ed]" the question to "whether a Chapter 11 case may be terminated by a 'structured dismissal' that distributes estate property in violation of the Bankruptcy Code's priority scheme." Justice Thomas was disinclined to answer the newly presented question because the parties had briefed only the first question, the justices would benefit from more guidance on the new question from other courts, and because he didn't want to encourage similar "bait-and-switch tactics." *Czyzewski v. Jevic Holding Corp*, No. 15-649, 2017 WL 1066259, at *15 (U.S. Mar. 22, 2017) (Thomas, J., dissenting) (citations omitted).

2 *Id.* (majority opinion).

3 *In re Jevic Holding Corp.*, 787 F.3d 173 (3d Cir. 2015), as amended (Aug. 18, 2015), cert. granted sub nom. *Czyzewski v. Jevic Holding Corp.*, 136 S. Ct. 2541 (2016), and rev'd and remanded sub nom. *Czyzewski v. Jevic Holding Corp.*, No. 15-649, 2017 WL 1066259 (U.S. Mar. 22, 2017).

4 *Jevic*, 787 F.3d at 182.

5 *United States v. AWECO, Inc.* (*In re AWECO, Inc.*), 725 F.2d 293, 295–96 (5th Cir. 1984).

6 *In re Iridium Operating, LLC*, 478 F.3d 452, 464 (2nd Cir. 2007).

cific and credible grounds to justify the deviation."[7] The Third Circuit acknowledged that such a justification would be rare.[8] While the Third Circuit admitted the decision was a "close call," ultimately, the Court held that under these facts, the bankruptcy court was justified in approving the structured dismissal because it was the "least bad alternative."[9]

II. The Issues

The Supreme Court recognized two issues in this case. First, did the truck driver Petitioners have standing to challenge the structured dismissal? Article III standing requires a plaintiff to have sustained an injury that could be alleviated through a favorable judicial decision. Second, can a bankruptcy case be terminated by a structured dismissal that does not comply with the Code's priority rules? The majority opinion held first, that the truck drivers did have standing, because overturning the structured dismissal could possibly redress their injury, and second, that a bankruptcy court could not approve a structured dismissal that was inconsistent with the Code's priority scheme without the consent of affected parties.

III. The First Issue: Standing

The Respondents argued that the truck driver Petitioners lacked standing to challenge the structured dismissal because they did not suffer an injury that could be redressed. Whether or not the structured dismissal was granted, they argued, the truck drivers were unlikely to recover on their judgment—the estate simply did not have enough funds to provide them a recovery.

The Court disagreed for two reasons. First, the Court found that a settlement respecting the priority rules was now possible. After the structured dismissal was negotiated, the WARN lawsuit against one of Jevic's secured creditors had concluded. Thus, the secured creditor may now be amenable to some sort of distribution to the truck drivers.

Second, the fraudulent conveyance action against Jevic's secured creditors could have value to the estate that could be realized in a Chapter 7 liquidation. Alternatively, if Jevic's case were dismissed, the truck drivers could pursue the fraudulent conveyance action themselves, which could result in a recovery to them. In sum, because the truck drivers were deprived of a recovery in the settlement and could possibly recover a portion of their judgment if the structured dismissal was overturned, the Court found that they had standing to challenge the structured dismissal.

IV. The Main Issue: The Legality of Structured Dismissals that Deviate From the Code's Priority Scheme

In coming to its ultimate conclusion, the Court continued its recent practice of leaning strongly towards the plain meaning rule of statutory construction when interpreting the Bankruptcy Code. Citing Justice Scalia's oft-quoted tenet that "Congress . . . does not, one might say, hide elephants in mouseholes,"[10] the Court concluded that Section 349(b)'s allowance of a deviation from a return to the prepetition status quo after a dismissal "for cause"[11] simply does not contemplate a final disposition of a bankruptcy case that violates the Code's priority scheme. Had Congress intended to allow such a result, the Court reasoned that Congress would have made such an intent clear.[12]

The Court cited two examples to illustrate that even when structured dismissals have been allowed under the authority granted to bankruptcy judges under Section 349(b) or 105(a), courts have not suggested that Congress intended structured dis-

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7 *Jevic*, 787 F.3d at 184 (internal quotation marks omitted).

8 *Id.* at 185–86 ("[W]e believe the Code permits a structured dismissal, even one that deviates from the § 507 priorities, when a bankruptcy judge makes sound findings of fact that the traditional routes out of Chapter 11 are unavailable and the settlement is the best feasible way of serving the interests of the estate and its creditors. . . . this result is likely to be justified only rarely . . . .")

9 *Id.* at 184, 185.

10 *Whitman v. Am. Trucking Associations*, 531 U.S. 457, 468 (2001).

11 When a bankruptcy case is dismissed, 11 U.S.C. § 349(b) allows a court "for cause," to modify *inter alia* the reinstatement of an avoided transfer or a voided lien; allow orders, judgments, and/or transfers to stand; and to modify the revesting of property of the estate back into the debtor.

12 "The importance of the priority system leads us to expect more than simple statutory silence if, and when, Congress were to intend a major departure. . . . [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." *Jevic*, No. 15-649, 2017 WL 1066259, at *10.

missals to act as a backdoor around the Code's priority scheme. *In In re Buffet Partners, L.P.*, out of the Northern District of Texas (by our very own Judge Hale),[13] none of the affected parties objected to the proposed structured dismissal. *In Iridium Operating*, out of the Second Circuit, the settlement did not contemplate a dismissal of the bankruptcy case, and merely provided for a distribution of settlement proceeds to a litigation trust that would pursue claims on behalf of the estate.[14]

As a relief to many practitioners, the Court distinguished first-day wage orders and critical vendor orders. Unlike structured dismissals, wage orders and critical vendor orders do not result in a final disposition of a bankruptcy case. Furthermore, they allow the debtor to continue operating as a going concern and to preserve value for the estate, provide the debtor a higher likelihood of completing a successful reorganization, and leave even "disfavored" creditors in a better position.

Even though the Third Circuit held that an acceptable departure from the priority scheme in structured dismissals would be "rare", the Supreme Court refused to allow even a limited concession to the priority rules. The Court expressed doubt that any such exception could be sufficiently defined and contained, and regardless, noted that the Code did not permit such an exception.[15]

Doubtlessly, many practitioners will be glad about this limited holding, which finally assuages fears about the Court determining the broader issue of whether structured dismissals, in general, are a permissible means of resolving a chapter 11 case.[16] The Supreme Court was careful not to express an opinion as to the legality of structured dismissals in general. This narrower holding will allow the continuation of the increasingly common practice of allowing structured dismissals and should do little to disturb non-case-dispositive orders in connection with an ongoing bankruptcy case.

13 No. 14-30699-HDH-11, 2014 WL 3735804 (Bankr. N.D. Tex. July 28, 2014).

14 *Iridium Operating*, 478 F.3d at 452.

15 *Jevic*, No. 15-649, 2017 WL 1066259, at *14 ("We cannot alter the balance struck by the statute. . . not even in rare cases" (citations omitted)).

16 Others, however, may feel as though this case is another in a line of cases from our nation's highest court leaving bankruptcy practitioners and judges "rowing upstream with an ever-shorter paddle" by reducing options in detriment to the practicalities associated with real-world bankruptcy cases. Donna Higgins, Jevic *Likely to Bring More Certainty, but Less Autonomy for Judges*, Bankruptcy Court Decisions Weekly News & Comments (April 13, 2017) http://westlaw.com.