

Client Alert

Financial Restructuring Practice Group

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Third Circuit Recognizes that “Structured Dismissal” Deviating from the Bankruptcy Code’s Priority Scheme May Be Used to Conclude Chapter 11 Bankruptcy Case

On May 21, 2015, the United States Court of Appeals for the Third Circuit, in a 2-1 opinion, recognized a Chapter 11 bankruptcy case could be dismissed through a “structured dismissal” that deviates from the priority scheme set forth in Section 507 of the Bankruptcy Code.¹ With its decision, the Third Circuit joined the Second Circuit in rejecting the Fifth Circuit’s *per se* exclusion on “structured dismissals” that deviate from the Bankruptcy Code’s priority scheme, providing secured creditors an option to end a Chapter 11 case where no plan could be confirmed and Chapter 7 liquidation is not a viable alternative.

Background

Jevic Transportation, Inc. and its affiliates (the “Debtors”) filed for Chapter 11 protection on May 20, 2008, two years after Sun Capital Partners (“Sun Capital”) acquired the company in a leveraged buyout. A group of lenders led by CIT Group (“CIT”) financed the buyout.

Following the bankruptcy filing, the Official Committee of Unsecured Creditors (the “Committee”) sued Sun Capital and CIT under various theories, including fraudulent transfer. After more than three years of litigation, the Debtors, CIT, Sun Capital and the Committee entered into a settlement. The Committee agreed to a “structured dismissal” of the Chapter 11 case, in which CIT and Sun Capital received releases from the Debtors and the Committee. In exchange, CIT paid \$2 million into an account earmarked to pay the Debtors’ and the Committee’s professional fees and other administrative expenses, and Sun Capital assigned its lien on the Debtors’ remaining \$1.7 million to a trust that would pay tax and administrative creditors first, and then general unsecured creditors on a pro rata basis. The settlement did not provide for any recovery by certain truck drivers of the Debtors, who had established priority wage claims against the Debtors under the Worker Adjustment and Retraining Notification Act (the “WARN Act Plaintiffs”).

The WARN Act Plaintiffs and the U.S. Trustee objected to the settlement, arguing that it did not comply with the priority scheme set forth in Section 507 of the Bankruptcy Code. The bankruptcy court overruled the objections and approved the settlement. The court found “there was ‘no realistic prospect’ of a meaningful distribution to anyone but the secured creditors . . . because the traditional routes out of Chapter 11 bankruptcy were

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impracticable” and “conversion to liquidation under Chapter 7 of the Bankruptcy Code would have been unavailing for any party”²

The WARN Act Plaintiffs appealed. The district court affirmed the bankruptcy court’s settlement approval order. The WARN Act Plaintiffs then appealed to the Third Circuit.

Third Circuit Majority Opinion

The majority joined the Second Circuit³ and rejected the Fifth Circuit’s approach,⁴ holding that “[B]ankruptcy Courts may, in rare instances like this one, approve structured dismissals that do not strictly adhere to the Bankruptcy Code’s priority scheme.”⁵ It reasoned that “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.”⁶ Because the bankruptcy court had “specific and credible grounds to justify [the] deviation,”⁷ including the fact that “there was ‘no prospect’” of a confirmable plan and the secured creditor would have quickly taken all estate assets in “short order” in a Chapter 7 case, the Third Circuit upheld the structured dismissal.

The Dissenting Opinion

In his dissent, Judge Scirica believed the case did not present extraordinary circumstances warranting departure from the priority rules. Rather, he thought the settlement was not “directed at estate-value maximization” and “structured dismissals” should only be permitted in instances where “the settlement’s deviation from the priority scheme was necessary to maximize the value of the *estate*”⁸—not just to permit payments to certain creditors of the estate who otherwise would have received no distribution. Ultimately, Judge Scirica believed the settlement should have allowed the WARN Act Plaintiffs to collect on their priority wage claims before any settlement proceeds could be distributed to creditors with lower priority claims.

Conclusion

The *Jevic* decision provides secured creditors an important tool to extract themselves from Chapter 11 cases where there are few, if any, options to conclude the case. By settling with key constituencies who agree to a “structured dismissal,” secured creditors might be able to avoid costly, time-consuming litigation with difficult creditors where the case economics and other unique circumstances justify such a result.

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¹ *Official Comm. of Unsecured Creditors v. CIT Grp. Bus. Credit Inc. (In re Jevic Holding Corp.)*, Case No. 14-1465, 2015 U.S. App. LEXIS 8380 (3d Cir. May 21, 2015).

² *Id.* at *10 (citing the bankruptcy court's opinion).

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

⁴ *In re AWECO, Inc.*, 725 F.2d 293, 295-96 (5th Cir. 1984).

⁵ *Id.* at *16.

⁶ 2015 U.S. App. LEXIS 8380 at *30.

⁷ *Id.* at *27 (citing *Iridium*, 478 F.3d at 466).

⁸ *Id.* at *34.