

SCOTUS overturns structured bankruptcy dismissal in favor of payment priority rules

“Chapter 11 permits some flexibility, but a court still cannot confirm a plan that contains priority-violating distributions over the objection of an impaired creditor class.” – U.S. Supreme Court Ruling in Czyzewski v. Jevic Holding Corp.



A landmark decision handed down last Wednesday from the U.S. Supreme Court reversed a bankruptcy court ruling that approved a “structured” Chapter 11 bankruptcy dismissal settlement for a collapsed trucking company. [WSJ reported](#) that, in the highly anticipated ruling, SCOTUS overturned a controversial payout plan that disregarded important bankruptcy rules.

In [Czyzewski v. Jevic Holding Corp.](#), the High Court ruled that the dismissal violates payment priority rules of the Bankruptcy Code as set out by Congress, which gives a special priority creditor status to employees who are owed unpaid wages. In the decision, SCOTUS sent the case back to bankruptcy court so that it may be properly adjudicated.

The Backstory

In 2006, private-equity firm Sun Capital Partners’ acquired Jevic Transportation, Inc. in a leveraged buyout, [according to the Wall Street Journal](#). By the following year, the company had started experiencing financial difficulty. In 2008, Jevic Transportation filed its Chapter 11 petition.

A day prior to the bankruptcy filing, Jevic ceased operations and about 90 percent of its employees were abruptly terminated. A group of the company's truck-driver force filed a multi-million dollar class-action lawsuit claiming that the layoffs violated the Worker Adjustment and Retraining Notification (WARN) Acts. According to Federal Regulation Title 20, Section 639.1(a), employers are required to give a 60-day notice of plant closings and mass layoffs.

The suit included over \$8 million in employee priority wage claims under Section 507(a)(4) of the Bankruptcy Code. Jevic truck drivers were awarded a judgment against Jevic, entitling the workers to payment ahead of general unsecured claims against the Jevic estate.

Another lawsuit was brought by the official committee of Jevic's unsecured creditors claiming fraudulent conveyance and equitable subordination against secured creditors, Sun Capital and CIT Group, which funded the LBO. During the course of Chapter 11 proceedings, Jevic stated that it had run out of money to fight the claims, which set into motion a settlement with the unsecured creditors' committee representing Jevic's unsecured creditors in the form of a structured dismissal. A [Delaware bankruptcy judge](#) approved a payout plan and dismissed the case.

The Controversy

Under the settlement negotiated by Sun, CIT, Jevic and the committee, no assets were to be distributed to the truck drivers despite the WARN Act class-action judgment. The settlement did, however, provide for distributions to general unsecured claims. The group of Jevic truck drivers appealed the bankruptcy court ruling to the U.S District Court for the District of Delaware and the Third U.S. Circuit Court of Appeals, but was the appeals were denied.

This past summer, the Supreme Court agreed to review the case.

At that time, the Wall Street Journal wrote:

“The question of what to do about bankruptcy rules that get in the way of a settlement has divided courts of appeal across the country, with some courts rejecting settlements that don’t comply with the scheme set out by Congress for who gets paid first.”

“The Bankruptcy Code contains a clearly-defined priority scheme for distributions to creditors of the bankruptcy estate, which is grounded on considerations of fairness to all creditors,” said [Clayton D. Ketter](#), a Director at Phillips Murrah who specializes in [financial restructurings and bankruptcy](#) matters.

The negotiated structured dismissal did not include the consent of the group of Jevic truck drivers, the SCOTUS opinion stated, which allowed Jevic to evade its priority-creditor responsibility to the unpaid drivers. As long as priority creditors don’t consent to the deal, such settlements can’t be approved, the High Court said.

“In the case before us, a Bankruptcy Court dismissed a Chapter 11 bankruptcy. But the court did not simply restore the prepetition status quo. Instead, the court ordered a distribution of estate assets that gave money to high-priority secured creditors and to low-priority general unsecured creditors but which skipped certain dissenting mid-priority creditors. The skipped creditors would have been entitled to payment ahead of the general unsecured creditors in a Chapter 11 plan (or in a Chapter 7 liquidation). See §§507, 725, 726, 1129. The question before us is whether a bankruptcy court has the legal power to order this priority-skipping kind of distribution scheme in connection with a Chapter 11 dismissal.

In our view, a bankruptcy court does not have such a power. 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 distributions of estate value in business bankruptcies,” [wrote Justice Breyer.](#)

“The Supreme Court’s ruling reinforces the enforceability of those priorities and clarifies that priority line jumping through a structured settlement will not be permitted,” Ketter said.

The Jevic case will now head back to bankruptcy court for more work.

The Takeaway

What are the implications of this decision, beyond the fairly narrow Supreme Court’s ruling? Will it affect the overall utilization of structured dismissals across the industry?

Ketter said that he has noticed a rise of structured dismissals in bankruptcy cases, which typically follow a sale of a substantial portion of the debtor’s assets.

“I don’t foresee the Jevic decision changing that,” he added. “The Supreme Court Justices did not say that structured dismissals are not allowed. Rather, they said that structured dismissals that violate the bankruptcy code’s priority scheme are not allowed. Thus, we are likely to continue to see structured dismissals used, so long as they do not impermissibly skip a class of creditors in making distributions.”

However, Ketter added that decision may have broader implications outside the realm of structured dismissals.

“For example, there are types of plans within a bankruptcy case where a priority class voluntarily gifts a portion of the recovery it would otherwise be due to a lower priority class,”

he added. "Sometimes, those gifted distributions skip other classes sitting higher on the priority scheme. The Jevic decision raises the question of whether such plans are permissible."

[Clayton D. Ketter](#) is a Director and a litigator whose practice involves a wide range of business litigation in both federal and state court, including extensive experience in financial restructurings and bankruptcy matters.