

Third Circuit Provides Road Map for Structured Dismissals

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In the past decade, Chapter 11 practice has witnessed the rise of a new phenomenon: structured dismissals.¹ Broadly speaking, the term structured dismissal is an umbrella term for a dismissal order that includes additional bells and whistles, such as releases, protocols for claims administration or provisions permitting the gifting of assets to junior stakeholders. Like a Chapter 11 plan, a structured dismissal often identifies how proceeds are to be distributed while retaining jurisdiction in the bankruptcy court for claims administration and other specified matters.

The U.S. Court of Appeals for the Third Circuit (the Court or Court of Appeals) recently confirmed that a structured dismissal may be permissible under certain circumstances, even if distributions made in connection with such dismissal do not adhere to Bankruptcy Code Section 507's priority scheme. *See In re Jevic Holding Corp.*, Case No. 14-1465, -- F.3d --, 2015 WL 2403443 (3d Cir. May 21, 2015).

Background

In 2006, a private equity fund (Sun) purchased all of the equity of a New Jersey-based trucking company (Jevic) in a leveraged buyout financed by a group of lenders led by CIT Group (CIT). In May 2008, Jevic terminated employees, began winding down its operations and filed a voluntary Chapter 11 petition.

Jevic's Chapter 11 filing spawned two important lawsuits. First, a group of Jevic's terminated truck drivers (the Drivers) filed a class action against Jevic and Sun alleging violations of federal and state Worker Adjustment and Retraining Notification (WARN) acts, seeking more than \$12 million (including more than \$8 million in priority wage claims). Second, the Official Committee of Unsecured Creditors (the Committee) brought an action against CIT and Sun, alleging, among other things, fraudulent and preferential conveyances (the Committee Action).

By March 2012, Jevic's remaining assets had dwindled to just the Committee Action and \$1.7 million in cash collateral that was subject to Sun's lien. All parties agreed that if the case converted to Chapter 7, Sun would get the cash collateral, and there would likely be no recovery for other constituents. The Committee, CIT, Sun and the Drivers entered into negotiations to settle the Committee Action. The negotiations resulted in a settlement agreement among the Committee, Jevic, CIT and Sun, but not the Drivers. The settlement was framed as a dismissal of Jevic's bankruptcy case, with the following key terms:

- CIT paid \$2 million to the estates to cover Jevic's and the Committee's legal fees and other administrative expenses;
- application of the \$1.7 million in cash collateral was applied to satisfy certain priority tax claims, with the remainder distributed pro rata among general unsecured creditors; and
- mutual releases among the settling parties.

The U.S. Trustee and the Drivers objected to the proposed settlement and dismissal. The Drivers argued that "even if structured dismissals are permissible, they cannot be approved if they distribute estate assets in derogation of the priority scheme of § 507 of the [Bankruptcy] Code." *Id.* at *6. However, the bankruptcy court overruled their objections and approved the settlement and structured dismissal. The bankruptcy court acknowledged the absence of Bankruptcy Code provisions authorizing the proposed

¹ Although not always the case, structured dismissals often occur in tandem with sales of substantially all of a debtor's assets.

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distribution and dismissal but noted that similar relief had been granted by other courts.² The bankruptcy court found that the evidence established that there was “no prospect” of a confirmable Chapter 11 plan, the secured creditors “would not do this deal in a Chapter 7[,]” a Chapter 7 conversion would therefore fail because a trustee would have no cash or other resources to fund prosecution of the Committee Action, and absent the settlement, there was “no realistic prospect” of meaningful distributions except for secured creditors. *In re Jevic Holding Corp.*, 2015 WL 2403443, at *3. Based on these findings, the bankruptcy court held that the “dire circumstances” justified approval of the settlement and structured dismissal. *Id.* The Drivers appealed to the district court, which affirmed, and then sought review by the Court of Appeals. *Id.* at *4.

Majority Decision³

The Court of Appeals seemed to view the case as presenting two discrete questions: (1) whether structured dismissals are permissible as a matter of law (*id.* at *4-6), and (2) whether a settlement arising as part of a structured dismissal may ever skip a class of objecting creditors in favor of more junior creditors (*id.* at *6-11).

Structured Dismissals. The Drivers argued that a structured dismissal is not permitted by the Bankruptcy Code, contending that the “only three exits” from Chapter 11 are plan confirmation, conversion to Chapter 7 and “plain dismissal with no strings attached.” *Id.* at *5. The Court rejected this argument, holding instead that “absent a showing that a structured dismissal has been contrived to evade the procedural protections and safeguards of the plan confirmation or conversion processes, a bankruptcy court has discretion to order [a structured dismissal].” *Id.* at *6. The Court suggested that different facts might warrant a different result in a future case, such as if there is the prospect of a plan process or worthwhile conversion — noting that the

² The bankruptcy court, in its bench ruling, stated as follows: “There is no express[] provision in the [Bankruptcy C]ode distribution and dismissal contemplated by the settlement motion. However, I do observe that while the practice is certainly neither favored nor commonplace[,], the record does reflect that this[] sort[] of relief has been granted by this and other court[s] in appropriate occasions in the past.” (Joint Appendix at 31).

³ The *Jevic* appeal was before Hon. Thomas M. Hardiman, Hon. Anthony J. Scirica and Hon. Maryanne Trump Barry. From the opinion authored by Judge Hardiman, Judge Scirica concurred and dissented in part. See generally *In re Jevic Holding Corp.*, 2015 WL 2403443, at *11-14. However, Judge Scirica’s dissent focused on whether the exclusion of the Drivers from the settlement was necessary on the facts of the case and did not directly address the propriety of structured dismissals. See *id.*

Drivers did not seriously dispute the Bankruptcy Court’s factual findings regarding the absence of prospects for a confirmable plan and the likelihood that conversion to Chapter 7 would be ineffective. *Id.* As a result, the permissibility of a structured dismissal in light of such circumstances remains an open question.

Priority and Class Skipping. The *Jevic* Court also addressed the question of “whether [pre-plan] settlements in th[e] context [of structured dismissals] may ever skip a class of objecting creditors in favor of more junior creditors.” *Id.* at *6. The Court concluded that this discrete question presented a “close call.” *Id.* at *9. The Court began its analysis by holding that “bankruptcy courts may approve settlements that deviate from the priority scheme” of Bankruptcy Code Section 507 if “specific and credible grounds ... justify [the] deviation.” *Id.* at *9 (quoting *In re Iridium Operating LLC*, 478 F.3d 452 (2d Cir. 2007)).⁴ The Court then turned to whether such specific and credible grounds were present. Based upon the bankruptcy court’s factual findings, including that the settlement and structured dismissal presented “the least bad alternative since there was ‘no prospect’ of a plan being confirmed and conversion to Chapter 7 would have resulted in the secured creditors taking all that remained of the estate in ‘short order[,]’” the Court affirmed. *Id.* at *9.

Key Takeaways

The *Jevic* decision confirms that, in the Third Circuit, a structured dismissal may be a viable alternative to conversion or outright dismissal. The opinion also provides a road map for the factual findings necessary to safeguard structured dismissals.

⁴ In agreeing with the Second Circuit’s decision in *Iridium Operating LLC*, *supra*, the Court of Appeals rejected a more stringent approach adopted by the Fifth Circuit in *In Matter of AWECO, Inc.*, 725 F.2d 293 (5th Cir. 1984), which held that the “fair and equitable” standard applies to settlements, and “fair and equitable” means compliance with the Bankruptcy Code’s priority scheme. *Id.* at 298.