

# AMERICAN BANKRUPTCY INSTITUTE JOURNAL

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## Structured Chapter 11 Dismissals: A Viable and Growing Alternative after Asset Sales

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In recent years, it has become commonplace for a chapter 11 debtor to utilize bankruptcy to effectuate an orderly sale of all or substantially all of its assets pursuant to § 363 of the Bankruptcy Code, prior to confirmation of a chapter 11 plan. This is especially true in cases where the pre-petition lender is undersecured and the case is administratively insolvent. After a sale of all or substantially all of a debtor's assets, which could be in the form of a going-concern or a liquidation, and absent the agreement of the undersecured creditor, the debtor is typically left with no unsecured assets to administer or with insufficient unsecured assets to fund a confirmable chapter 11 plan.



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Chapter 11 debtors have traditionally chosen among three possible courses of action after a sale of their assets. First, a debtor could proceed with confirmation of a liquidating chapter 11 plan, which requires compliance with

§§ 1123 and 1129. The path of a chapter 11 liquidating plan is consequently not available to every debtor, as a liquidating plan requires enough cash to satisfy administrative-expense and priority claims and to fund the chapter 11 plan process. This is a particular challenge in cases involving an undersecured creditor

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or unpublished), there have been a number of rulings that are useful to understanding how structured dismissals have been presented by parties and viewed by courts. We begin with a discussion of the statutory bases

relied on for structured dismissals, what factual showing might be required to obtain a structured dismissal and common provisions approved in structured dismissal orders.<sup>1</sup>

### Statutory Framework

Parties requesting approval of structured dismissals rely on § 1112(b)

## Cover Feature

with a blanket lien on all of a debtor's assets, especially without that secured creditor's agreement to fund the often-significant costs of both a liquidating plan and the plan process. Second, a debtor could convert the chapter 11 case to a case under chapter 7 and allow a chapter 7 trustee to distribute a debtor's

remaining assets, if any, to creditors and to prosecute any available avoidance actions. Third, a debtor could seek entry of a simple order dismissing the chapter 11 case, returning the parties to their state law rights and remedies. This article discusses a less common but increasingly used approach known as a "structured" dismissal. A structured dismissal is a dismissal coupled with some or all of the following additional provisions in the dismissal order: releases (some more limited than others), protocols for reconciling and paying claims, "gifting" of funds to unsecured creditors and provisions providing for the bankruptcy court's continued retention of jurisdiction over certain post-dismissal matters.

Although cases involving structured dismissals have not yet resulted in memorandum decisions (published

and/or § 305(a)(1) of the Bankruptcy Code. Structured-dismissal motions grounded in either statutory provision are often coupled with a request pursuant to § 105(a) of the Code, which allows a bankruptcy court to enter orders that are "necessary or appropriate to carry out the provisions of" the Code. 11 U.S.C. § 105(a).

Section 1112(b), governing conversion or dismissal of a chapter 11 case, is generally utilized as the statutory basis for a structured dismissal when a debtor has administered its assets and is either administratively insolvent and/or lacks the funding to proceed with confirmation

<sup>1</sup> This article is intended to highlight structured dismissal as a possible option for a debtor to consider following a pre-confirmation "all asset" sale(s). It is not intended to take a position regarding the appropriateness of a structured dismissal in the first instance; the factual showing (if any) required to obtain a structured dismissal before any particular court, or the propriety of any particular provision in a structured-dismissal order.

of a liquidating chapter 11 plan.<sup>2</sup> Section 1112(b)(1) provides, in part, that “the court shall convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, if the movant establishes cause.” 11 U.S.C. § 1112(b)(1). Section 1112(b)(4) contains a non-exhaustive list of circumstances justifying “cause” under § 1112(b)(1).

Two primary justifications advanced by proponents of structured dismissals are that there exists “a substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation,” and that the debtor is unable to effectuate substantial consummation of a plan. *See id.* at §§ 1112(b)(4)(A), (M).<sup>3</sup> Because § 1112(b)(4)’s list is non-exhaustive, in cases where cause might not fit neatly in one of the stated provisions of § 1112(b)(4), parties argue that a bankruptcy court is not limited to the examples of “cause” listed in § 1112(b)(4).<sup>4</sup> Assuming that “cause” exists, a bankruptcy court is required to convert or dismiss the chapter 11 case, “absent unusual circumstances...that the requested conversion or dismissal is not in the best interest of creditors and the estate.” 11 U.S.C. § 1112(b)(1). In the context of structured-dismissal requests, parties assert that the costs of converting to and administering a case under chapter 7, as well as the enhanced provisions in the structured dismissal order, are in the best interest of creditors and the estate and that dismissal is a preferable remedy over conversion.

Section 305 has provided additional statutory support for obtaining a structured dismissal in some cases. Section 305 provides, in part, that the court may dismiss a case under any chapter of the Bankruptcy Code if “the interests of creditors and the debtor would be better served by such dismissal.” 11 U.S.C. § 305(a)(1). Although § 305 has historically been used to dismiss involuntary cases, courts have found the statute to be applicable to voluntary cases as well.<sup>5</sup>

Because a dismissal under § 305(a) is not appealable, 11 U.S.C. § 305(c), courts universally recognize that § 305(a) is an “extraordinary remedy,” and that “dismissal is appropriate under § 305(a)(1) only where both ‘creditors and the debtor’ would be ‘better served’ by a dismissal.”<sup>6</sup> Indeed, several courts have noted that, “[g]ranteeing an abstention motion pursuant to § 305(a)(1) requires more than a simple balancing of harm to the debtor and its creditors; rather, the interests of both the debtor and its creditors must be served by granting the requested relief.”<sup>7</sup>

### Required Factual Showing

The statutory grounds for dismissal under §§ 1112(b)(2) and 305(a)(1) are relatively straightforward. “Cause” must be established under § 1112(b)(2), and the dismissal must be in the best interest of the debtor and creditors under § 305(a)(1). Given the absence of reported or unreported decisions on the subject, however, the application of these standards in the context of structured dismissals is not so clear.

Before considering the factual record necessary for approval of a structured-dismissal motion, a bankruptcy court may first question the propriety of a structured dismissal as a matter of law. In so doing, a court may take the view that the Code does not authorize a structured dismissal, and that a structured dismissal equates to a *sub rosa* plan. Therefore, such a court might find that the debtor has three choices post-sale: (1) proceed with confirmation of a liquidating chapter 11 plan, (2) convert the case to chapter 7 and allow a chapter 7 trustee to administer the assets or (3) dismiss the case via a simple dismissal order with no “bells and whistles.”<sup>8</sup>

If a bankruptcy court finds that structured dismissal is permissible, which most courts considering the issue to date appear to conclude, the next question is what factual showing is necessary to justify entry of a structured dismissal order. Although there are no definitive answers, three factual scenarios describe the circumstances in which most structured dismissals have been approved to date.

The first such case is one in which the debtor’s assets have been sold in the chapter 11 case but the debtor is administratively insolvent or is potentially administratively solvent and does not have the means to fund the confirmation process.<sup>9</sup> Proponents of such structured dismissals focus primarily on the argument that “cause” exists under §§ 1112(b)(4)(A) and (M), because the debtor cannot confirm a chapter 11 plan, and that conversion is not in the best interest of creditors due to costs associated with conversion to and administering of a chapter 7 case. In these cases, dismissal primarily is grounded in one of two structures: (1) the debtor proposes to pay administrative and priority creditors a *pro rata* distribution, with no payments to unsecured creditors; or (2) the debtor proposes to pay unsecured creditors without paying administrative and priority creditors in full, through the creation of a trust funded by a “gift” consensually carved out of the undersecured senior lender’s recovery as part of a settlement agreement. A “gift” trust settlement could be entered into as part of the sale process and carried over into a dismissal motion, or made part of a consensual motion to dismiss the case. Either way, a carve-out gift trust has served as a vehicle for granting a recovery to subordinate creditors in a way that would likely violate the absolute priority rule in a plan scenario.

The second type of case is one in which the debtor has liquidated all of its assets and potentially could confirm a chapter 11 liquidating plan.<sup>10</sup> In such cases, proponents argue that a structured dismissal is most appropriate because funding the plan process would eliminate or reduce the remaining pot of money available for distribution to pay unsecured creditors. Parties seeking approval of such structured dismissals typically argue that § 1112(b)(4)’s list of what constitutes “cause” for dismissal is nonexclusive and that the bankruptcy court has broad discretion to approve a structured dismissal, if it is in the best interest of creditors.<sup>11</sup>

<sup>2</sup> In at least one case, § 305(a)(1) was used as the sole-statutory basis to obtain a structured dismissal, on the grounds that the debtor was likely administratively insolvent and therefore could not confirm a plan. *See In re CSI Inc.*, Case No. 01-12923 (REG) (Bankr. S.D.N.Y. July 24, 2006) [Dkt. No. 284] (Motion). In addition, in *In re KB Toys Inc.*, Case No. 08-13269 (KJC) (Bankr. D. Del. Feb. 16, 2010) [Dkt. No. 993] (Order), the court entered a dismissal order under both §§ 1112(b) and 305(a)(1).

<sup>3</sup> Prior to the adoption of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), proponents of structured dismissals typically relied on former § 1112(b)(4)(2), which provided that cause included the “inability to effectuate a plan.” *See In re Cape May Care Ctr. Inc.*, Case No. 00-41945 (NLW) (Bankr. D. N.J. Dec. 13, 2004) [Dkt. No. 313] (Motion).

<sup>4</sup> *See In re Foamex Int'l Inc.*, et al., Case No. 09-10560 (KJC) (Bankr. D. Del. Nov. 18, 2009) [Dkt. No. 712] (Motion).

<sup>5</sup> *See, e.g., In re Monitor Single Lift I Ltd.*, 381 B.R. 455, 463 (Bankr. S.D.N.Y. 2008).

<sup>6</sup> *Id.* (citing several cases in support of limited application of § 305(a)(1)).

<sup>7</sup> *See, e.g., id.* (citations omitted).

<sup>8</sup> In *In re BT Holding III LLC*, Case No. 09-11173 (CSS) (Bankr. D. Del. Oct. 5, 2009), the court denied the debtors’ and creditors’ committee’s joint motion for entry of a structured dismissal order on the grounds that it was premature and that no current controversy existed that required a court order. In so ruling, however, the court questioned, in *dicta*, whether any basis existed in the Bankruptcy Code for a dismissal order with “extra bells and whistles,” such as the retention of post-dismissal jurisdiction and claims administration procedures. Transcript of Oct. 5, 2009 hearing, at 47, lines 1-15.

<sup>9</sup> *See Foamex* [Dkt. No. 712] (Motion dated Nov. 19, 2009); *Alternative Distr. Sys. Inc.*, Case No. 09-13099 (PJW) (Bankr. D. Del. Nov. 3, 2009) [Dkt. No. 194] (Motion); *In re Wickes Holdings LLC*, Case No. 08-10212 (KJC) (Bankr. D. Del. 2008) [Dkt. No. 1346] (Motion); *In re Princeton Ski Shop Inc.*, Case No. 07-26206 (MS) (Bankr. D. N.J. Dec. 23, 2008) [Dkt. No. 472] (Motion); *In re New Weatherhane Retail Corp.*, Case No. 04-11649 (PJW) (Bankr. D. Del. Aug. 4, 2005) [Dkt. No. 543] (Motion).

<sup>10</sup> *See BT Holding* [Dkt. No. 268] (Motion dated July 23, 2009); *In re Dawhare's of Lexington LLC*, Case No. 08-51381 (JMS) (Bankr. E.D. Ky. Dec. 10, 2008) [Dkt. No. 304] (Motion); *In re Blades Board & Skate LLC*, Case No. 03-48818 (NLW) (Bankr. D. N.J. June 7, 2004) [Dkt. No. 110] (Motion).

<sup>11</sup> In at least one case, the proponent argued that “cause” existed under § 1112(b)(4)(A) because there was nothing left to reorganize post-sale, and that a plan of “reorganization” could not be confirmed. *In re BAG Liquidation Ltd.*, Case No. 08-32096 (SGJ) (Bankr. N.D. Tex. Aug. 14, 2009) [Dkt. No. 672] (Motion).

The final scenario where structured dismissals are sought is where a debtor's assets have not been fully administered by way of a pre-confirmation sale process, but rather a workout has been achieved. In such cases, proponents have relied on § 305(a)(1) as the primary statutory basis for relief, as opposed to § 1112(b). There is at least one published opinion with this scenario, *In re Colonial Ford Inc.*<sup>12</sup> In that case, the debtor entered into a pre-petition workout that had the effect of restructuring the entire company and resolving multiple litigations. The debtor then filed a voluntary chapter 11 case and the creditors moved for an order of abstention from bankruptcy under § 305(a)(1). The court granted the motion, holding that “[s]ection 305(a)(1) reflects a policy, embodied in several sections of the Code, which favors ‘workouts’: private, negotiated adjustments of creditor-company relations.”<sup>13</sup> The court further noted that such an out-of-court workout would require near universal agreement among the creditors and would need to be adequate to rehabilitate the business outside of bankruptcy.

The more recent case of *In re Magnolia Energy LP*<sup>14</sup> also used § 305(a)(1) as the basis to grant the debtor's motion to dismiss the chapter 11 case. In that case, after the chapter 11 filing, the debtors' indirect equity-holder was able to obtain refinancing that would be used, in part, to pay creditors in full. The order granting the motion provided for payment of all scheduled claims, all professional claims and the establishment of a \$300,000 reserve account to pay any other claims that might not have been properly scheduled. The order conditioned dismissal on a subsequent closing, including evidence that the payments contemplated by the order had been made.

The previous two scenarios illustrate cases where structured dismissals were approved even though a chapter 11 plan was at least feasible. Notwithstanding that economic reality, given the apparent growing trend of approved structured dismissals throughout the country, debtors (and their senior secured creditor(s) and the creditors' committees) may more frequently consider structured dismissal as a cheaper and quicker alternative to a liquidating chapter 11 plan. In fact, the efficacy and cost of a liquidating plan and the confirmation process might be questioned altogether,

under the appropriate set of facts, if a structured dismissal with satisfactory provisions could be obtained.

## Relief Granted in Structured-Dismissal Orders

Orders entered approving structured dismissals in various jurisdictions have proven one thing: A number of courts have been willing to date to sign structured-dismissal orders that arguably go well beyond earlier plain-vanilla dismissal orders, although most have been entered consensually. The absence of reported or unreported decisions makes it difficult to predict how bankruptcy courts might view certain provisions in the future, particularly in contested situations. Consideration of the types of relief granted in various structured-dismissal orders entered since 2004 may provide some guidance. The most frequently used provisions fall into five general categories:

1. *Release and exculpation provisions.* Several structured-dismissal orders contain release provisions, some being broader in scope than others. The scope of releases ranges from the more traditional releases seen in a chapter 11 plan,<sup>15</sup> to releases limited to actions related to the structured-dismissal motion.<sup>16</sup>

2. *Claims reconciliation process and distribution procedures.* Most structured-dismissal orders contain some type of claims-reconciliation process. While exact language of the orders varies, they generally attempt to incorporate an expedited, cost-effective way to reconcile claims and distribute funds to creditors. In some cases, claims are allowed in the amounts submitted in the dismissal motion, in the absence of an objection.<sup>17</sup> In one case, creditors were required to object to amounts stated in the dismissal motion, and pay the costs associated with contesting any such objection.<sup>18</sup> Another case incorporated an *omnibus* claim objection into the dismissal motion, binding creditors who failed to object.<sup>19</sup>

Structured dismissal orders with claim reconciliation procedures typically also contain provisions similar to those

contained in chapter 11 plans governing distributions. Such provisions include minimum distribution limitations, check-cashing periods, limitations of the number of distributions to be made and authorization to donate nominal remaining amounts to charity.

3. *Carveouts and “gift” trusts.* As part of negotiating an acceptable sale order, or later a consensual structured dismissal, a debtor's senior secured lender often agrees to carve out a portion of its collateral from the proceeds of sale and “gift” it to a trust. If an estate does not have sufficient funds to pay administrative and priority claims, and therefore cannot confirm a plan, a structured-dismissal order usually is premised on distributing the gift-trust money to a debtor's unsecured creditors.<sup>20</sup> On the other hand, if administrative and priority claims are being paid in full, and a gift trust is not formally established, the remaining assets will simply be set aside for the payment of unsecured creditors after administrative and priority claims are fully satisfied.<sup>21</sup>

4. *Conditions to dismissal.* Most structured-dismissal orders (even some providing for claims reconciliation and distributions after entry of the order) do not contain conditions to dismissal. At least one structured-dismissal order, however, has placed conditions subsequent on dismissal become effective.<sup>22</sup>

5. *Enforceability of prior orders and retention of jurisdiction.* Structured-dismissal orders often provide that, notwithstanding § 349 of the Bankruptcy Code, prior orders of the court survive dismissal.<sup>23</sup> Another common provision appearing in structured-dismissal orders is a provision providing for a bankruptcy court's retention of jurisdiction—usually at least over fee applications and/or implementation of the structured-dismissal order.<sup>24</sup> Last, the vast majority of structured-dismissal orders were entered only after notice of the motion to dismiss was provided to all creditors.

## Conclusion

Although there are very few reported or unreported decisions approving structured dismissals, there is clearly a

<sup>12</sup> 24 B.R. 1014 (Bankr. D. Utah 1982).

<sup>13</sup> *Id.* at 1015.

<sup>14</sup> Case No. 06-11069 (MFW) (Bankr. D. Del. Feb. 12, 2007) (*Magnolia*) [Dkt. No. 196] (Order).

<sup>15</sup> *Cape May* [Dkt. No. 313] (order entered Dec. 23, 2004) (releases approved for debtors, secured lender, official committee, their estates, shareholders, officers and directors and counsel, for everything up to date of dismissal order).

<sup>16</sup> *Dawarhane's* [Dkt. No. 304] (order entered Dec. 18, 2008); *In re Harvey Electronics Inc.*, Case No. 07-14051 (ALG) (Bankr. S.D.N.Y. Dec. 16, 2008) [Dkt. No. 177] (Order); *New Weatherlane* [Dkt. No. 566] (order entered Sept. 2, 2005).

<sup>17</sup> *Wickes* [Dkt. No. 1346] (order entered March 23, 2009); *Blades* [Dkt. No. 126] (order entered June 7, 2004).

<sup>18</sup> *New Weatherlane* [Dkt. No. 566] (order entered Sept. 2, 2005).

<sup>19</sup> *CSI* (Bankr. S.D.N.Y. July 24, 2006) [Dkt. No. 271] (order entered July 24, 2006).

<sup>20</sup> *Wickes* [Dkt. No. 1346] (order entered March 23, 2009).

<sup>21</sup> *Blades* [Dkt. No. 126] (order entered June 7, 2004).

<sup>22</sup> *Magnolia* [Dkt. No. 196] (order entered Feb. 12, 2007) (dismissal not effective until certification of counsel filed evidencing payment of claims).

<sup>23</sup> *See, e.g., In re CFM U.S. Corp.*, Case No. 08-10668 (KJC) (Bankr. D. Del. Feb. 1, 2010) [Dkt. No. 1282] (Order); *New Weatherlane* [Dkt. No. 566] (order entered Sept. 2, 2005).

<sup>24</sup> *Princeton* [Dkt. No. 546] (order entered Dec. 23, 2008); *Dawarhane's* [Dkt. No. 304] (order entered Dec. 18, 2008); *Harvey* [Dkt. No. 177] (order entered Dec. 15, 2008).

trend developing where courts are more frequently entering orders approving structured-dismissal orders containing varying degrees of “bells and whistles,” as opposed to “plain vanilla” dismissal orders. Many of those cases involve § 363 sales in chapter 11 of all or substantially all of the debtor’s assets in situations of administrative insolvency. In others, a confirmed chapter 11 plan is feasible, but the court instead approves a structured-dismissal order with some of the provisions that one would expect to see in a plan. Whatever the factual scenario, one thing is clear: If you are representing a debtor or an official committee in a chapter 11 case, a structured dismissal along the lines of the cases described in this article may now be the quickest and most cost-effective way to conclude your chapter 11 case. ■

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