By Lisa S. Gretchko and Paul R. Hage

Nuts and Bolts of the Structured Dismissal of a Chapter 11 Case

Lisa S. Gretchko
Howard & Howard Attorneys PLLC
Royal Oak, Mich.

Paul R. Hage
Jaffe Raitt Heuer & Weiss, PC
Southfield, Mich.

Lisa Gretchko is a member of Howard & Howard Attorneys PLLC and is ABI's Vice President-Publications. Paul Hage is a partner with Jaffe Raitt Heuer & Weiss, PC, previously served as a coordinating editor for the ABI Journal *and is a 2017 ABI "40 Under 40" honoree. Both serve on ABI's Board of Directors and are based in Michigan.*

For decades, the conventional wisdom was that no matter why a business filed for chapter 11, there were only three ways for it to exit: (1) confirmation of a plan (which could include a liquidating plan); (2) conversion to chapter 7; or (3) dismissal. Increasingly, however, chapter 11 cases are filed for the purpose of conducting so-called "free and clear" sales of substantially all of a business's assets pursuant to § 363. Once such a sale is complete, the key stakeholders need to determine a debtor's exit strategy in the case.

Upon the closing of a § 363 sale, proceeds are frequently distributed to secured creditors on account of their claims and liens. Depending on the purchase price for the assets, the estate might be administratively insolvent or close thereto. Plan confirmation in this scenario is a challenge because of the expenses and delays associated with the plan-confirmation process, as well as the general confirmation requirement that all administrative expenses must be paid in full. Traditional dismissal is not an attractive alternative because, pursuant to § 349(b),[1] dismissal generally returns the debtor to the *status quo ante*, as if the bankruptcy case had not been filed, which could vitiate important orders in the case.[2] In addition, conversion to a chapter 7 case might do nothing more than add another layer of administrative expenses (in the form of fees payable to a chapter 7 trustee and its counsel).

Faced with these unappealing options, creative counsel and courts have found a fourth way for a business to exit chapter 11: a "structured dismissal." Structured-dismissal orders have been characterized as a hybrid dismissal and confirmation order. Per such orders, the case's dismissal is subject to certain prior or contemporaneous orders of the bankruptcy court (*e.g.*, orders selling assets, approving settlements or authorizing distributions), which remain effective notwithstanding case dismissal. Whereas traditional dismissal normally returns a debtor to its pre-petition state, a structured dismissal extends certain benefits obtained during the bankruptcy case post-dismissal without the cost or delay associated with confirming a liquidating plan. Commentators have observed that structured dismissals are "an increasingly common approach to concluding a chapter 11 case in which parties are unable to confirm a plan."[3]

Law Regarding Structured Dismissals

It is debatable whether the text of the Bankruptcy Code authorizes structured dismissals. In addition to § 105(a), proponents of structured dismissals generally rely on the introductory language in § 349(b) (*i.e.*, "Unless the court, for cause, orders otherwise...."), which allows a court to alter the presumptive effect of dismissal set forth in that section. These are the "magic words" that breathe life into the concept of a structured dismissal.

Section 349(b)'s legislative history suggests that the purpose of the section's introductory language was to allow courts to modify the scope of dismissal "to protect rights acquired in reliance on the bankruptcy case."[4] In addition, § 305(a) provides courts with discretion to "dismiss a case ... if the interests of creditors and the debtor would be better served" by a dismissal, and § 1112(b)(1) allows a court to convert or dismiss a chapter 11 case, "whichever is in the best interests of creditors and the estate."

Objectors to structured dismissals (often U.S. Trustees) claim (1) they constitute *sub rosa* plans intended to evade the procedural safeguards and plan-confirmation requirements set forth elsewhere in the Bankruptcy Code, (2) broad interpretation of the introductory language in § 349(b) allows the exception to effectively swallow the rule, and (3) the three traditional exit paths for a debtor in chapter 11 are the only paths that exist in the Bankruptcy Code. These objections have generally been overruled by the courts.[5]

1 Section 349(b) provides, in pertinent part:
(b) Unless the court, for cause, orders otherwise, the dismissal of a case…
(1) reinstates —
(A) any proceeding or custodianship superseded under section 543 of this title
(B) any transfer avoided under section 522, 544, 545, 547, 548, 549, or 724(a) of this title, or preserved under section 510(c)(2), 522(i)(2), or 551 of this title; and
(C) any lien avoided under section 506(d) of this title;
(2) vacates any order, judgment, or transfer ordered, under section 522(i)(1), 542, 550, or 553 of this title; and
(3) revests the property of the estate in the entity in which such property was vested immediately before the commencement of the case under this title.

2 "A dismissal typically 'revests the property of the estate in the entity in which such property was vested immediately before the commencement of the case' — in other words, it aims to return to the pre-petition financial *status quo*." *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973, 979 (2017).

3 *See Collier on Bankruptcy* (16th ed. 2017), ¶ 1112.08, p. 1112-62.1 (citing ABI Commission to Study the Reform of Chapter 11, 2012-2104, Final Report and Recommendations, n.973 (2014)), *available at* commission.abi.org/full-report).

4 *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 338 (1977).

5 *But see In re Biolitec Inc.*, 528 B.R. 261 (Bankr. D.N.J. 2014) (rejecting proposed structured dismissal as invalid under Bankruptcy Code).

What Factors Determine Whether a Structured Dismissal Is Appropriate?

The business debtor's inability to reorganize or efficiently confirm a plan is the most obvious prerequisite for a structured dismissal, but other factors should be evaluated. For example, if the debtor has viable causes of action or other assets that could generate a meaningful recovery for creditors, then structured dismissal is not in the best interests of the estate. Instead, the case should remain in bankruptcy (either in chapter 11 or 7), where such assets can be liquidated by a fiduciary.

Case law illustrates other factors that bankruptcy courts consider when deciding whether to approve a structured dismissal. In *In re Buffet Partners LP*,[6] the court approved a structured dismissal of the bankruptcy case as being in the best interests of creditors. The debtors owned and operated a buffet-style restaurant chain. Shortly after filing their bankruptcy petition, the debtors sought court authority to sell substantially all of their assets to their secured lender. The creditors' committee investigated the conduct of the secured lender and its liens, along with claims against the debtors' assets. Thereafter, the committee and debtors jointly filed a motion for approval of a settlement that resolved all open issues in the case, paid administrative expenses and priority claims in full, and provided a meaningful recovery for unsecured creditors. The settlement contemplated a structured dismissal after the closing of the sale. Notice of the structured-dismissal motion was given to all creditors, but only the U.S. Trustee objected.

The court ruled that §§ 349(b) and 1112(b) provide authority for structured dismissals. The court acknowledged that "[n]ot much law, statutory or otherwise, exists regarding structured dismissals of this type."[7] Nevertheless, the court found that conversion or confirmation of a chapter 11 liquidating plan, as requested by the U.S. Trustee, "would add significant and unnecessary time and expense."[8] The court explained:

> [T]he economic value of the Debtor in this case will be served by dismissing the case, rather than converting it. Converting this case to chapter 7 would interfere with prompt and efficient payment to creditors, a primary goal of chapter 11. The parties with the skin in the game do not wish to prolong the distribution of funds to creditors by a conversion to chapter 7, which undoubtedly will do just that. Nor do those parties want to go through the time and expense of a plan, which will cause the pool of money left to be greatly diminished.[9]

Given appropriate notice and a process that does not "illegally or unfairly trample on the rights of parties," the court concluded that the structured dismissal should be approved.[10] Finally, the court emphasized "that not one party with an economic stake" in the case had objected to the proposed structured dismissal.[11]

Similarly, in *Naartjie Custom Kids Inc.*,[12] the court approved a structured dismissal requested by the debtor and creditors' committee over the U.S. Trustee's objection where substantially all of the debtor's assets had been sold. The debtor contended that a structured dismissal was appropriate because there were no causes of action to be pursued, the claims-reconciliation process would be completed before the case was dismissed, notice of the motion to dismiss had been provided to all parties-in-interest, and no party with an economic stake had objected.

The court found authority to approve a structured dismissal in §§ 305(a), 349(b) and 1112(b), and noted that there was "no dispute that the economy and efficiency of administration would be better served through a structured dismissal."[13] The court reasoned that there was a finite amount of assets, and to have the debtor move forward with confirmation would diminish the return to creditors. The court concluded that while it appreciated the U.S. Trustee's arguments, such arguments "appear to be better suited to those cases where there are myriad loose ends, lack of unanimity of support from creditors, and a failure to address the needs of creditors."[14]

Finally, in *In re Olympic 1401 Elm Associates LLC*,[15] the court expressly held that "a structured dismissal is contemplated by the Bankruptcy Code and may at times be a better mechanism to conclude a reorganization case."[16] The debtor sought to dismiss its case after the completion of a § 363 sale, which generated sufficient proceeds to pay all non-insider claims in full. The debtor argued that a structured dismissal was warranted because it avoided unnecessary administrative expenses that might dilute the distribution available for creditors. Only the U.S. Trustee objected.

The court held that a structured dismissal was proper under §§ 105(a), 305(a) and 1112(b) where the debtor sought to minimize unnecessary administrative expenses and ensure an expeditious and orderly conclusion to the bankruptcy case. The court found that the structured dismissal was fair and equitable, did not reflect an attempt to circumvent the requirements of plan confirmation through a *sub rosa* plan, and complied with the absolute priority rule. The court concluded that entry of the dismissal order was in the best interests of all creditors and that, in contrast, "continuing the bankruptcy case ... was likely to harm the creditors by diminishing their recovery on claims."[17]

Jevic Holding Corp.

The U.S. Supreme Court's *Jevic* decision[18] is now the most well-known case involving a structured dismissal. The issue in *Jevic* was whether the bankruptcy court could approve a structured-dismissal order that violated the Bankruptcy Code's priority scheme over the objection of adversely impacted creditors. Reversing the Third Circuit Court of Appeals, the Supreme Court concluded it could not. Rather, the Court held that, absent consent from impacted parties, a distribution scheme ordered in connection with a

6 *In re Buffet Partners LP*, 2014 WL 3735804 (Bankr. N.D. Tex. July 28, 2014).
7 *Id.* at *2.
8 *Id.* at *3.
9 *Id.*
10 *Id.*
11 *Id.* at *4.
12 *Naartjie Custom Kids Inc.*, 534 B.R. 416 (Bankr. D. Utah 2015).
13 *Id.* at 425.
14 *Id.* at 427.
15 *In re Olympic 1401 Elm Assocs. LLC*, 2016 WL 4530602 (Bankr. N.D. Tex. Aug. 29, 2016).
16 *Id.* at *1.
17 *Id.* at *2.

continued on page 62

from page 13

structured dismissal cannot deviate from the basic priority rules that apply under the Code.

In so ruling, however, the Court stated, "Although the Code does not expressly mention structured dismissals, they 'appear to be increasingly common.'" [19] The Court also stated that the language contained in § 349 authorizing the bankruptcy courts, for cause, to "order otherwise" was designed to give bankruptcy courts flexibility when dismissing cases "to protect reliance interests acquired in the bankruptcy."[20]

Such statements have caused many commentators to opine that the Supreme Court tacitly approved of structured dismissals that (1) comply with the absolute priority rule, and/or (2) are consented to by all adversely impacted creditors. Seizing on such language, a number of courts have approved structured dismissals post-*Jevic*.[21]

What Should Be in the Structured Dismissal Order?

In order to increase the likelihood that a bankruptcy court will enter a structured-dismissal order, certain steps should be taken. First, the structured-dismissal order should contain a finding that "cause" exists for the structured dismissal, and the record should describe the circumstances creating such cause. For example, to the extent that the structured dismissal benefits creditors by increasing the funds available for distribution while reducing the administrative expenses to be incurred by quickly and efficiently closing the case, such benefit should be referenced in the record (*e.g.*, the motion for structured dismissal, the court's statements on the record and/or the structured dismissal order itself).

Second, especially when the structured dismissal follows a § 363 sale or court-approved settlement, the structured-dismissal order should provide that all orders entered in the bankruptcy case continue in full force and effect post-dismissal, and that the bankruptcy court retains jurisdiction relating to the implementation of the structured-dismissal order or any other order entered in the chapter 11 case.

Third, the structured-dismissal order should not be entered until after the bar date(s) for administrative expenses (including professional's fees) and unsecured claims has passed, and the universe of allowed expenses and claims has been finally determined pursuant to a claims-reconciliation process that is reasonable under the circumstances.

Fourth, in order to satisfy *Jevic*, any distribution contemplated under the order should comply with the absolute priority rule or, alternatively, note that adversely impacted creditors have consented to any deviation from the absolute priority rule. To the extent that the structured-dismissal distribution contemplates secured creditor carve-outs or "gifting" to junior creditors in exchange for their support, such provisions should be disclosed.

Fifth, some courts require that the structured-dismissal order list the proposed distributions to be made in a manner similar to a final report in a chapter 7 case (*e.g.*, the claim amount and the amount to be distributed on that claim), and give parties notice and time *after* entry of the structured-dismissal order in which to object to the order itself — just like creditors get time to object to the trustee's final report in a chapter 7 case.

Sixth, the order should appoint a responsible person to supervise the distribution process (note that officers and key employees of the debtor may leave to work for the purchaser from the § 363 sale) and should provide that any funds remaining after the completion of the final distribution (*e.g.*, uncashed checks) may be distributed *pro rata* to creditors in a subsequent distribution. Thereafter, the order should authorize the responsible person to donate any remaining funds to charity and take any steps necessary to formally dissolve the debtor.

Seventh, the bankruptcy court will not dismiss the bankruptcy case until the completion of all of the conditions/tasks set forth in the structured-dismissal order. Consequently, a structured-dismissal order usually contains a provision requiring debtor's counsel to file a certification to that effect.

Various stakeholders may ask for certain additional provisions in the structured-dismissal order. For example, the U.S. Trustee generally requests a provision requiring payment of all quarterly fees due under 28 U.S.C. § 1930 through the closing of the case. Creditors may want a provision requiring the debtor to certify that there are no additional assets to be pursued in the case, and that unpursued claims and causes of action are not likely to result in an increased distribution to creditors. They may also want a provision requiring the debtor to file a motion to reopen the bankruptcy case if additional assets of the debtor are located, discovered or arise after the case is dismissed.

Finally, in some cases the debtor or other stakeholders will ask for various exculpations and releases for debtor and nondebtor parties in the dismissal order. Because a structured dismissal is not the same as a reorganization plan and typically does not result in a reorganization, these requests are likely to draw vigorous objections from creditors, the creditors' committee and the U.S. Trustee, along with close scrutiny from the bankruptcy court.

Conclusion

Upon the conclusion of a § 363 sale, structured dismissals are increasingly being used as *the* exit strategy for debtors and their stakeholders. Although the Supreme Court reversed the approval of the structured-dismissal order in *Jevic* because it violated the Bankruptcy Code's priority scheme without the consent of the adversely impacted creditors, the Court's language in *Jevic* suggests that a structured dismissal might be approved where such defects do not exist. Practitioners seeking approval of a structured dismissal are encouraged to consider some of the "nuts and bolts" provisions and procedures highlighted in this article in connection with such requests. abi

18 *Czyzewski v. Jevic Holdings Corp.*, 137 S. Ct. 973 (2017).
19 *Id.* at 978.
20 *Id.* at 985.
21 The authors are aware of several post-*Jevic* cases where structured dismissals were approved. Nevertheless, as of this writing, there do not appear to be any published opinions post-*Jevic* expressly approving structured dismissals.