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Structured Dismissals: The Least Worst Option?

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Introduction

On its face, the Bankruptcy Code[1] offers a debtor only three paths to exit from chapter 11: confirmation of a plan, conversion of the case to chapter 7, or outright dismissal. Only the first of these is generally considered a "successful" outcome, but the journey toward confirmation is often expensive, and the path is littered with various obstacles (read: statutory requirements) to be overcome by the debtor on the road to confirmation. Where confirmation is impracticable or unachievable, the debtor is left to choose between conversion and dismissal: the former puts the estate into the hands of a third party trustee to initiate a fire sale liquidation, the latter pushes the debtor back "on the street" to face its creditors without the process and protection the Bankruptcy Code offers. For a corporate debtor in financial distress, neither of these two options presents a welcome solution.

In recent years, however, the prospect of another alternative has begun to emerge for debtors that have successfully liquidated their assets (often through a § 363 sale or Rule 9019 compromise and settlement) yet cannot confirm a chapter 11 plan: the structured dismissal. Dubbed "the least worst option" by one bankruptcy judge, the notion of a controlled exit from chapter 11 has begun to take root as a means to accomplish at least some of what the debtor entered bankruptcy for while avoiding the utter failure that a straight dismissal often represents.

The purpose of this paper is to provide a brief overview of what structured dismissals are, what statutory authority exists for their approval and the objections or obstacles that may arise to their approval.

The "Least Worst Option"

What is a structured dismissal?

The phrase "structured dismissal" is arguably something of a misnomer. While often thought of as a dismissal with "bells and whistles," it could as easily be thought of as a § 363 sale or Rule 9019 settlement followed by dismissal of the case. This is because the structured dismissal is often proposed in the context—or promptly following—the sale of substantially all the debtor's assets pursuant to § 363 or the approval of a global compromise and settlement resolving substantially all open issues in the case pursuant to Fed. R. Bankr. P. 9019.

[1] Unless otherwise indicated, all section (§) references herein are to the United States Bankruptcy Code.

However denominated, a structured dismissal commonly includes one or more (or all) of the following features:[2]

- Procedures to reconcile claims, adjudicate claims objections, and make distributions to the holders of allowed claims, , which may include a specified claim allowance;[3]

- Gifting provisions by which some portion of a secured creditor's recovery may be allocated to the payment of administrative and priority claims, and possibly unsecured claims, too;[4]

- Release and exculpation provision, ranging from more limited releases related to the dismissal itself to global releases protected all involved parties.

Perhaps most importantly, a structured dismissal can achieve this without losing the benefit of any progress made in the case to that point.

Ordinarily, dismissal of a case triggers § 349(b), which reinstates stayed proceedings and voided transfers, vacates certain orders, and revests all property of the estate in the debtor.[5] As the legislative history to § 349(b) explains, "[t]he basic purpose of the subsection is to undo the bankruptcy case, as far as practicable, and to restore all property rights to the position in which they were found at the commencement of the case."[6] A structured dismissal can override the presumptive return to *status quo ante* imposed by § 349(b), thus preserving the effect of any of any orders previously entered by the bankruptcy judge during the pendency of the case.

The considerations that may play into a decision whether to seek a structured dismissal include (i) whether the bar date has passed so the total claims population is known, (ii) whether the estate is administratively solvent, (iii) whether and how estate professionals may be compensated for services rendered, (iv) the value of remaining assets (or the cash proceeds thereof), (v) whether further work is needed to identify and reconcile all potential claims, and (vi) the level of "finality" needed for parties in interest.

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[2] *See, e.g., In re Strategic Labor, Inc.*, 467 B.R. 11, 18 n.10 (Bankr. D. Mass. 2012); *In re Felda Plantation, LLC*, 2012 WL 1965964 (Bankr. M.D. Fla. May 29, 2012). *See also* Michael J. Lichtenstein, *Asset Sales and Structured Dismissals in Chapter 11*, PRATT'S J. OF BANKR. L. 22, 27 (Jan. 2014); Dennis J. Connolly & Nadjia Bailey, *Current Issues Related to the Use of Structured Dismissals in Bankruptcy Cases*, 2011 ANN. SURVEY. OF BANKR. L. 1, 2 (2011); Norman L. Pernick & G. David Dean, Structured Chapter 11 Dismissals: A Viable and Growing Alternative after Asset Sales, 29 AM. BANKR. INST. J. 5 (June 2010) [the "***Pernick Article***"].

[3] *See, e.g., In re Wickes Holdings LLC*, No. 08-10212 (Bankr. D. Del. Mar. 20, 2009); *In re Blades Board & Skate LLC*, No. 03-48818 (Bankr. D.N.J. Jun. 7, 2004); *In re New Weathervane Retail Corp.*, No. 04-11649 (Bankr. D. Del. Sep. 2, 2005).

[4] *See, e.g., Wickes*.

[5] 11 U.S.C. § 349(b).

[6] H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 337-38 (1977).

With these considerations in mind, three scenarios in particular typically lend themselves to consideration of a structured dismissal: (i) where the debtor is administratively insolvent or potentially administratively solvent and does not have the means to fund the confirmation process;[7] (ii) where the debtor has liquidated all of its assets and has sufficient funds to confirm a plan, but in doing so would leave little or nothing available for distribution to unsecured creditors;[8] and (iii) where a debtor's assets have otherwise been administered pursuant to an out-of-court workout.[9]

The Statutory Authority

There is a relative dearth of published case law to guide bankruptcy petitioners with respect to structured dismissals.[10] And although the dismissal of a case is authorized in both § 1112(b) and § 305(a) of the Bankruptcy Code, nowhere does the Bankruptcy Code expressly address the concept of a *structured* dismissal.

Pursuant to § 1112(b), a chapter 11 case may be dismissed (or converted to chapter 7) "for cause."[11] In considering whether to dismiss a case "for cause" under § 1112(b), "[c]ourts are charged with determining whether a conversion or dismissal is in the best interests of creditors and the estate."[12]

Section 1112(b)(4) also provides a nonexclusive list of what may constitute cause for dismissal or conversion, including "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.[13] Thus, the dismissal of a case is specifically contemplated where a debtor is administratively insolvent or has insufficient assets to substantially consummate a plan.

In addition, § 305(a)(1) allows a court to dismiss—or abstain from hearing—a case if "the interests of *creditors and the debtor* would be better serviced by such dismissal or suspension."[14] Section 305(c), however, is more commonly applied to dismiss involuntary cases;

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[7] For cases involving structured dismissals and administrative insolvency, *see Alternative Distr. Sys. Inc.*, No. 09-13099 (Bankr. D. Del. Nov. 3, 2009); *Wickes*; *Princeton Ski Shop*.

[8] *See, e.g., In re BT Holding III LLC*, No. 09-11173 (Bankr. D. Del. Oct. 5, 2009); *Dawarhare's*; *Blades Board & Skate*.

[9] *See, e.g., In re Colonial Foods*, 24 B.R. 1014 (Bankr. D. Utah 1982). *See also, generally*, Pernick Article, *supra* n. 2, at 3-4.

[10] *See In re Buffett Partners, L.P.*, 2014 WL 3735804, at *2 (Bankr. N.D. Tex. Jul. 28, 2014).

[11] 11 U.S.C. § 1112(b).

[12] *Buffett Partners*, 2014 WL 3735894, at *2; *see also* 11 U.S.C. § 1112(b)(2) (prohibiting dismissal under § 1112(b)(1) "if the court finds and specifically identifies unusual circumstances establishing that converting or dismissing the case is not in the best interests of creditors and the estate").

[13] 11 U.S.C. § 1112 (b)(4)(A), (M).

[14] 11 U.S.C. § 305(a) (emphasis added).

but has also been found applicable to voluntary cases. Nevertheless, because an order of dismissal under § 305(a) is not appealable, it is generally considered an extraordinary remedy.[15]

As structured dismissals are often proposed within the context of a global compromise and settlement, the standards for the approval of compromises and settlement in bankruptcy cases are also relevant. Approval of a settlement under Rule 9019(a) traditionally requires consideration by the court of: (i) the probabilities of litigation success; (ii) the difficulties of collecting any litigated judgments; (iii) the complexity of the litigation and the expense, inconvenience and delay necessarily attending it; and (iv) the paramount interests of the creditors and interest holders of the estate.[16] Bankruptcy courts have held that these standards are generally satisfied provided the settlement does not "fall below the lowest point in the range of reasonableness."[17] In such cases, therefore, the court's responsibility is "to canvass the issues and see whether the settlement falls below the lowest point in the range of reasonableness."[18]

Finally, because the Bankruptcy Code does not explicitly contemplate structured dismissals, § 105(a) is commonly also invoked to fill in the gaps left between the dismissal provisions of the Bankruptcy Code and the court's broad authority to approve compromises.

Common Objections to Structured Dismissals

Objections to structured dismissal (when they arise) commonly come from the Office of the United States Trustee, which—

> Seeks to promote the efficiency and protect the integrity of the Federal bankruptcy system. To further the public interest in the just, speedy and economical resolution of cases filed under the Bankruptcy Code, the Program monitors the conduct of bankruptcy parties and private estate trustees, oversees related administrative functions, and acts to ensure compliance with applicable laws and procedures.[19]

As one judge noted, "this court looks to the UST to raise issues to cause it to stop and completely consider a matter even when no creditor objects."[20] Thus, even in situations where the structured dismissal of a case is proposed and supported by all creditor constituencies, the US

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[15] *See In re Monitor Single Lift I LTD*, 381 B.R. 455, 462-63 (Bankr. S.D.N.Y. 2008).

[16] *See*, *e.g.*, *American Can Co. v. Herpel (In re Jackson Brewing Co.)*, 624 F.2d 605, 607–08 (5th Cir. 1980).

[17] *See*, *e.g.*, *In re Idearc, Inc.*, 423 B.R. 138, 182 (Bankr. N.D. Tex. 2009).

[18] *In re Drexel Burnham Lambert Group, Inc.*, 134, B.R. 493, 496-97 (Bankr. S.D.N.Y. 1991) (citations omitted).

[19] United States Department of Justice, *About the United States Trustee Program*, http://www.justice.gov/ust/eo/ust_org/index.htm (last checked November 2, 2014).

[20] *Buffet Partners*, 2014 WL 3735804, at *4.

Trustee often steps in with an objection to ensure that the proposed dismissal does not "sacrifice critical bankruptcy safeguards included in the traditional statutory options."[21]

Some common objections raised by the US Trustee are:

- Structured dismissals essentially determine the terms of a chapter 11 plan, particularly where combined with a prior asset sale or Rule 9019 settlement, and are therefore merely a "new permutation" of *sub rosa* plan of the sort deemed impermissible in *Braniff* and its progeny.[22]

- Structured dismissals ignore certain safeguards of the chapter 11 confirmation process, including disclosure, voting and acceptance and "fair and equitable" standards such as the absolute priority rule.[23]

- Structured dismissals may contain release provisions that run afoul of § 1141(d)(3) (barring non-individual debtor discharges) or § 524(e) (barring the discharge of nondebtor obligations).

- Structured dismissals may alter or subvert the claims resolution process, and may impose extra burdens on creditors whose claims would otherwise enjoy *prima facie* validity of scheduled and filed claims by virtue of Fed. R. Bankr. P. 3003(b) and § 502(a).[24]

- Structured dismissals may contain gifting provisions that allow funds allocated for distribution to "skip" a class of creditors in violation of the absolute priority rule, or without providing disclosure sufficient to allow creditors to properly evaluate the proposed distribution.[25]

Understanding these objections—and the responses to them—is crucial to understanding how a structured dismissal can be, well, *structured* within the statutory limits of the Bankruptcy Code.

Select Case Studies

Given that structured dismissals are a relatively new mechanism utilized in bankruptcy cases, instances involving structured dismissals have not resulted in many memorandum decisions (published or unpublished). Indeed, the distinct lack of published, precedential case law circumscribing the contours of the structured dismissal is a testament to the fact-specific,

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[21] Nan Roberts Eitel, T. Patrick Tinker & Lisa L. Lambert, *Structured Dismissals, or Cases Dismissed Outside of the Code's Structure*, 30 AM. BANKR. INST. J. 20 (March 2011) [hereinafter, the "***USTP Article***"].

[22] USTP Article, *supra* n. 21, at 20. *See also PBGC v. Braniff Airways Inc. (In re Braniff Airways Inc.)*, 700 F.2d 935 (5th Cir. 1983).

[23] *Id.*

[24] *Id*.

[25] *Id.*

unpredictable nature of the concept. Nevertheless, past attempts at obtaining court approval of a structured dismissal can be a valuable guide to what works—and what doesn't.

In *In re Buffet Partners, L.P.*,[26] a settlement was proposed in which (i) the Debtors' assets would be sold, (ii) unpaid administrative expenses (including professionals' fees) would be assumed by the buyer, (iii) $500,000 would be paid into a trust for the benefit of unsecured creditors, (v) the buyer would waive its remaining unsecured deficiency claim, and (vi) the buyer, the debtors, and the official committee would execute mutual releases. Following the sale of the debtors' assets, a motion to dismiss the case was filed proposing dismissal upon certification that the claims reconciliation process was complete, funds had been disbursed to unsecured creditors, and final fee applications had been finally adjudicated. The proposed dismissal order also overruled § 349(b) and allowed for all prior orders to remain in effect. In overruling the US Trustee's objection and approving the dismissal, the court noted that "if appropriate notice is given and the process is fair and does not illegally or unfairly trample on the rights of parties, the proposal should be approved."[27] Also important to the court's decision was the fact that no party with an economic stake in the case objected,[28] and that the originally-proposed settlement was fair and equitable, did not constitute an impermissible *sub rosa* plan and did not violate the absolute priority rule.[29]

Also in this district, in *In re Broadstar Wind Systems Group LLC*,[30] the Debtor first obtained authority to sell substantially all of its assets to its secured lender, which credit bid for the assets and agreed to gift an amount sufficient to return a small (~4%) distribution to unsecured creditors. After consummation of the sale, the only outstanding claims remaining were certain administrative expenses (including professional fees) and unsecured claims. With the sale consummated, the Debtor filed a motion for entry of an order establishing a mechanism for the adjudication of any disputed claims, authorizing the disbursement to unsecured creditors, dismissing the case, and waiving the effect of § 349(b). The Debtor presented evidence to show that any recovery to unsecured creditors would be depleted by a plan confirmation process, and the US Trustee did not object to the dismissal. The order dismissing the case provided a mechanism for the payment of claims and the retention of jurisdiction by the court to the extent necessary to rule on the allowance of professional fees. Of note, the dismissal order provided that "that the allowance of claims pursuant to Exhibit 1 is solely for determination of the proper amount to be distributed to the creditor and shall not be used for any other purposes, including res judicata in a subsequent proceeding by either the Debtors or the creditor."

A similar procedural sequence was followed in *In re Dawahare's of Lexington, LLC*.[31] As in *Buffet Holdings*, the debtor in *Dawahare's* filed its motion for entry of a dismissal order (with provisions nullifying the effect of § 349(b)) *after* having already consummated a global settlement authorized by prior order of the bankruptcy court. In *In re Blades Board and Skate,*

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[26] 2014 WL 3735804 (Bankr. N.D. Tex. Jul. 28, 2014).

[27] *Id*.

[28] *Id.*

[29] *Id.*

[30] No. 10-33373 (Bankr. N.D. Tex. May 24, 2011).

[31] No. 08-51381 (Bankr. E.D. Ky. Dec. 10, 2008).

LLC, too, the motion for dismissal came after the approval of a settlement establishing a fund to pay professional fees and unsecured claims.[32] All other administrative expenses (other than professional fees) and secured creditors had been paid, and the bar date for the filing of proofs of claim in the case had already passed.[33] Significantly, the dismissal motion noted that only a 5% distribution to unsecured creditors was anticipated.[34] No objections were filed, and the court approved the dismissal.[35]

Contrasting with these outcomes, another recent case from the Northern District of Texas, *In re Oryon Technologies, Inc.*,[36] offers an example of a proposed structured dismissal that was not sufficient to assure the court that necessary statutory and procedural protections of the Bankruptcy Code were fully satisfied. Among other terms, the proposed settlement offered to pay all administrative expenses and most unsecured claims in full while a handful of disputed claims would be "assumed" and paid by the debtors (on undisclosed terms) post-dismissal. The settlement also provided for the execution of mutual releases among the debtors and certain major creditors and the dismissal of the case. Significantly, however, the proposed settlement made no attempt at claims reconciliation—indeed, a claims bar date had not yet been set in the case—nor offered any procedure to adjudicate the disputed claims. The US Trustee objected, citing among other concerns the disparate treatment of disputed claims and the lack of any provision for unscheduled claims that might be asserted in subsequent proofs of claim. Sustaining the US Trustee's objection, the court denied the settlement motion.

[32] No. 03-48818 (Bankr. D.N.J. Jun. 7, 2004).

[33] *Id.*

[34] *Id.*

[35] No. 03-48818 (Bankr. D.N.J. Jun. 29, 2004).

[36] No. 14-32293 (Bankr. N.D. Tex. Jul. 10, 2014).