Maintaining Control Over Your Bankruptcy

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July 2021

A recent ruling by Judge Glenn in the Bankruptcy Court for the Southern District of New York shows that notwithstanding the U.S. Supreme Court's *In re Jevic* decision,[1] structured dismissals of chapter 11 cases are still permissible and in some instances more beneficial to creditors than confirmation of a plan or conversion to a chapter 7 liquidation.

Background

On its face, the Bankruptcy Code gives insolvent businesses two avenues to deal with their debts. First, a company can file for a case under chapter 7 where a trustee will be appointed to liquidate all of the company's assets as soon as possible. On the other hand, where a company's value is best preserved by continuing to stay in business, chapter 11 allows it to maintain operations while negotiating a court-supervised sale and/or plan of reorganization to maximize creditor recoveries. In practice, however, many chapter 11 cases do not result in a confirmed plan of reorganization but instead a sale of substantially all of the debtor's assets followed by a so-called "structured dismissal" that bears some of the hallmarks of a confirmation order but without all of the procedural and substantive creditor protections afforded by section 1129 of the Bankruptcy Code. Such dismissals are governed by section 349(b), which typically restores the debtor and its creditors to the *status quo* ante but may also add additional terms and conditions that may affect creditors' rights based on the facts and circumstances of the particular case. "[2]

In those chapter 11 cases where continuing the proceeding is unlikely to benefit creditors more than dismissing the case, the court may order a dismissal "for cause" so long as the terms of the dismissal do not otherwise violate the Bankruptcy Code. In *Jevic*, the Court was tasked with determining whether the "fair and equitable" requirements to confirm a non-consensual plan should also apply to a structured dismissal under section 349. Put another way, the Court considered whether there was valid "cause" under the facts of the case for a structured dismissal that deviated from some of the requirements to confirm a plan under section 1129 of the Bankruptcy Code.. For example, a bankruptcy court may confirm a non-consensual plan of reorganization over a creditor's objection so long as the creditor receives what it would have gotten under a chapter 7 proceeding (the "best interest test"), and the plan is "fair and

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[1] *Czyzewski v. Jevic Holding Corp. (In re Jevic)*, 137 S.Ct. 973 (2017).

[2] 11 U.S.C. § 349(b) (permitting dismissal orders that may alter the *status quo ante* "for cause".

equitable." Depending on the circumstances, "fair and equitable," means that the objecting creditor either receives property equal to the value of their claim, or, alternatively, that no lower-priority creditor receives *anything* under the plan—the so called Absolute Priority Rule ("APR").[3] While the APR expressly applies to non-consensual chapter 11 plans, until *Jevic* it was unclear whether it also applied to structured dismissals.

The *Jevic* Decision

In 2006, a private equity firm called Sun Capital Partners, Inc. ("Sun") purchased Jevic Transportation Corporation ("Jevic") in a leveraged buyout. Sun financed the transaction with funds borrowed from CIT Group Business Credit Inc. and other lenders (collectively "CIT"). Sun was unsuccessful in making Jevic profitable and in 2008, Jevic ceased operations and laid off all its employees. Shortly thereafter, it filed for Chapter 11 bankruptcy.

Jevic's drivers successfully sued under state and federal laws requiring 60 days' notice of cessation of business, and were awarded a judgment that included about $8.3 million of priority wage claims. Under the Bankruptcy Code's priority rules, the workers' claims were junior to Sun and CIT's secured loans, but senior to other general unsecured claims against Jevic. Meanwhile, a committee of Jevic's unsecured creditors sued Sun and CIT for allegedly saddling Jevic with unsustainable debts that led to its bankruptcy.

Sun, CIT, Jevic, and the committee ultimately reached a settlement agreement, which included a structured dismissal of Jevic's chapter 11 case. One of the terms of the agreement was that Sun would pay the unsecured creditors on a *pro rata* basis out of the remainder of Jevic's assets, *without paying anything to Jevic's former employees*. This provision violated the APR, and was at the heart of the dispute. The workers challenged the structured dismissal in federal district court and the Third Circuit, which both affirmed the bankruptcy court's decision.

The U.S. Supreme Court, however, agreed with the workers, holding that structured dismissals may not contravene the APR "without the affected creditors' consent," and reversed.[4] The Court argued that the purpose of "for cause" dismissals under section 349(b) was to "give courts the flexibility to protect reliance interests acquired in the bankruptcy, not to make general end-of-case distributions that would be flatly impermissible in a Chapter 11 plan or Chapter 7

[3] 11 U.S.C. § 1129(b)(2) (2021).
[4] *Jevic* at 983.

liquidation."[5] By this logic, the Court distinguished (and approved) *interim* distributions of assets pursuant to an ongoing chapter 11 proceeding which do not conform to the APR from *final* distributions under a confirmed plan of reorganization.

The *In re KG Winddown LLC* decision

On June 9, 2021, Judge Martin Glenn of the Southern District of New York Bankruptcy Court approved a structured dismissal *In re KG Winddown LLC*.[6] The case involved a consolidated chapter 11 proceeding of various companies ("Debtors") which owned and operated multiple locations of a restaurant chain. The Debtors sold nearly all of their assets to a group of creditors in a section 363 sale, which permits businesses in bankruptcy to sell substantially all of their assets outside of a plan. The sale left the Debtors' estate without the means to pay off all of their administrative claims, but debtor's counsel consented to a reduction in fees so that those claims debts could be satisfied out of the sale proceeds. The Debtors and creditors also entered into Transition Services Agreements whereby the Debtors intended not to terminate the chapter 11 proceedings until relevant liquor licenses were transferred from current to new ownership. As of a few days prior to Judge Glenn's decision, the creditors were still waiting for two liquor licenses. The Debtors moved for a structured dismissal of their chapter 11 cases, and the U.S. Trustee objected on multiple grounds. For these purposes, the most relevant objection was that dismissal was premature because the liquor licenses had not yet been transferred.

The court determined as a preliminary matter that a structured dismissal under the facts of the cases would not run afoul of either *Jevic* or the APR. First, due to the circumstances of the case, the parties could not be restored to their pre-petition positions. Judge Glenn reasoned that:

> [t]he Debtors have sold substantially all their assets, have no further operations, and have insufficient resources to fund a plan. The other alternatives . . .—conversion to chapter 7 or appointment of a trustee or examiner—would impose costs that would only further erode the value of the already administratively insolvent estates with no apparent benefit, and are therefore not 'in the best interests of creditors and the estate[s].'[7]

[5] *Id*. at 977.
[6] 2021 WL 2350839 (Bankr. S.D.N.Y. June 9, 2021).
[7] *Id.* at *5.

The "for cause" dismissal contemplated here did not violate the APR or *Jevic* because creditors *consented* to the proposed dismissal and the only objecting party, the U.S. Trustee, did not have a pecuniary interest in the outcome. From here, the court easily rejected the U.S. Trustees' objections and dismissed the proceedings.

In re KG Winddown LLC provides a useful roadmap for how to craft structured dismissals that will hold up in a post-*Jevic* world. As emphasized by Judge Glenn, under the facts and circumstances of these chapter 11 cases, a structured dismissal led to a far superior result for creditors than keeping the cases alive while the estate continued to rack up expenses and seek confirmation of a plan that would offer them no meaningful distributions. Furthermore, the court seemingly endorsed, in dictum, that section 363 sales, which are evaluated under the business judgment rule, may under certain conditions render structured dismissals unnecessary. Therefore, it may be possible for a debtor to draft a sale order that includes some of the procedural and substantive safeguards of section 1129 and still protect the "reliance interests acquired in the bankruptcy" as contemplated by the *Jevic* Court. In other words, *In re KG Winddown LLC* may be read to suggest that creative debtors can devise a sale order subject to the business judgment rule that mimics some of the aspects of a structured dismissal without running afoul of *Jevic*. Only time will tell whether Judge Glenn's decision was simply the logical extension of *Jevic's* limited holding or a blueprint for proactive debtors to devise more expansive structured dismissals that otherwise would not pass muster under a plan of reorganization.

If you have any questions or concerns about how to maintain control over your bankruptcy, please contact our Bankruptcy Group.

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