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New York Bankruptcy Court Approves Two Structured Dismissals Post-*Jevic*

In two recent rulings, the Bankruptcy Court for the Southern District of New York confirmed that structured dismissals are viable options for debtors to exit bankruptcy notwithstanding the Supreme Court's *Jevic* decision. In *Jevic*, the Supreme Court held that structured dismissals cannot be approved over the dissent of affected creditors if distributions are made to junior creditors in violation of the Bankruptcy Code's absolute priority rule.¹ The Supreme Court, however, stopped short of prohibiting structured dismissals outright or expressing a broader view about their legality.² The two recent New York bankruptcy court rulings confirm that structured dismissals are feasible options for debtors to exit bankruptcy so long as they do not violate the absolute priority rule and otherwise comply with applicable Bankruptcy Code provisions.

Background: *Jevic*

A chapter 11 debtor that pursues a sale of substantially all of its assets is often left with no meaningful estate value after consummation of the sale and application of the sale proceeds in satisfaction of its secured debt. Traditionally, a debtor in these circumstances has three options to emerge from bankruptcy: confirm a liquidating chapter 11 plan; convert to chapter 7; or simply dismiss its bankruptcy case. Structured dismissals—which enjoyed some popularity prior to the Supreme Court's 2017 *Jevic* ruling—present a fourth option. In a structured dismissal, the debtor obtains an order that dismisses its chapter 11 case and also provides for the administration of its remaining assets.³ Structured dismissal orders often included claim reconciliation and noticing procedures, as well as distribution mechanics, that mimicked similar provisions typically reserved for confirmed chapter 11 liquidating plans. Some chapter 11 debtors preferred structured dismissals to plan confirmation or conversion because, among other things, structured dismissal orders were seen as generally less costly, time consuming and uncertain than those alternatives. Importantly, structured dismissal orders also could provide releases and exculpations for the debtors' insiders and others, and sometimes included settlements that distributed estate assets to otherwise out-of-the-money stakeholders (with the consent of affected senior creditors), all without satisfying the requirements for confirming a chapter 11 plan.

The Supreme Court's decision in *Jevic*, however, put an end to one feature of structured dismissals—distributions that do not follow ordinary priority rules without the affected creditors' consent. In *Jevic*, the debtors had liquidated substantially all of their assets for the benefit of their secured lenders, leaving the estates with only \$1.7 million in cash and certain fraudulent conveyance actions. Instead of converting to chapter 7 or trying to confirm a liquidating chapter 11 plan, the debtors pursued a structured dismissal of their cases in accordance with a settlement that, among other things, created a trust for distributing their remaining assets to administrative creditors, and any remaining cash to general unsecured creditors on a pro rata basis. The U.S. Trustee and certain holders of priority employee-related claims objected to the structured dismissal arguing that the proposed

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

² *See id.* at 985.

³ Structured dismissals have been defined as a “hybrid dismissal and confirmation order . . . that . . . typically dismisses the case while, among other things, approving certain distributions to creditors, granting certain third-party releases, enjoining certain conduct by creditors, and not necessarily vacating orders or unwinding transactions undertaken during the case.” *Jevic*, 137 S. Ct. at 979 quoting American Bankruptcy Institute Commission to Study the Reform of Chapter 11, 2012–2014 Final Report and Recommendations 270 (2014).

class-skipping distributions to general unsecured creditors before payment of the senior employee claims violated the absolute priority rule. The bankruptcy court overruled the objection. It recognized that the settlement agreement violated the Bankruptcy Code's priority rules, but held that this did not bar approval because the proposed payouts occurred pursuant to a structured dismissal, not a chapter 11 plan.⁴ The Third Circuit affirmed on appeal. The Supreme Court reversed, holding that structured dismissals cannot be approved over the dissent of affected creditors if distributions are made to junior claimants (the general unsecured creditors) before payment of senior claimants (the priority wage-related creditors) in violation of the Bankruptcy Code's absolute priority rule, even if such distributions derived from senior creditor recoveries pursuant to a settlement.⁵

A&P's Structured Dismissal

The grocery store chain Great Atlantic & Pacific Tea Co. (together with its co-debtor affiliates, better known as "A&P")⁶ sought structured dismissal of its cases after liquidating substantially all of its assets, leaving it with insufficient funds to confirm a plan.⁷ A&P argued that converting its chapter 11 cases to chapter 7 would do nothing more than create substantial additional administrative expenses and delay as a result of the appointment of a chapter 7 trustee, without any corresponding benefit to A&P's creditors.⁸

A&P's proposed structured dismissal provided, among other things, for: (a) the dismissal of all of the A&P debtors' chapter 11 cases other than that of the lead debtor; (b) preserving the lead debtor as a wind-down company tasked with administering A&P's remaining assets and reconciling disputed administrative expense claims; and (c) exculpation of A&P and its sole secured creditor and unions, the statutory committee for unsecured creditors appointed in the cases (the "UCC") and each of the aforementioned parties' related parties, in each case with respect to claims related to A&P's chapter 11 cases. Importantly, the structured dismissal order distributed A&P's assets in accordance with the Bankruptcy Code's priority provisions: first, to its remaining secured creditors; second, to creditors holding administrative expense claims; and only thereafter, third, to junior claimants such as general unsecured creditors. A&P expected that its dismissal order would, after distribution of its collateral to its secured creditors, result in an approximately 20% recovery for administrative claims, and no recovery for any junior creditors.⁹

The U.S. Trustee and McKesson Corp. (a dissenting member of the UCC) objected to A&P's efforts to dismiss its cases in this way, arguing that A&P's chapter 11 cases should instead be liquidated in chapter 7.¹⁰ The objectors argued that the proposed structured dismissal was a veiled attempt to implement a plan of liquidation without adhering to the Bankruptcy Code's confirmation requirements. They acknowledged that the proposed structured dismissal did not run afoul of the central holding in *Jevic*—that a structured dismissal must not deviate from the Bankruptcy Code's priority rules without the affected creditors' consent.¹¹ However, the objectors maintained that *Jevic* should be interpreted broadly as holding that *any* proposed plan-like relief that circumvents the Bankruptcy Code's procedural safeguards was improper.¹² The U.S. Trustee's objection emphasized

⁴ *Id.* at 981-82.

⁵ *Id.* at 983.

⁶ Hr. Tr., Case No. 15-23007 (RDD) (Bankr. S.D.N.Y. May. 11, 2021) [ECF No. 4813]. Judge Drain's order authorizing final resolution of A&P's chapter 11 cases was entered three days later. Case No. 15-23007 (RDD) (Bankr. S.D.N.Y. May 14, 2021) [ECF No. 4810].

⁷ Case No. 15-23007 (RDD) (Bankr. S.D.N.Y. Mar. 19, 2021) [ECF No. 4726] ¶¶ 48, 51.

⁸ *Id.* at ¶ 5.

⁹ *Id.* at ¶¶ 4, 48.

¹⁰ Case No. 15-23007 (RDD) (Bankr. S.D.N.Y. Apr. 23, 2021) [ECF No. 4770] ("U.S. Trustee Obj."); Case No. 15-23007 (RDD) (Bankr. S.D.N.Y. May 6, 2021) [ECF No. 4792] ("McKesson Obj.").

¹¹ 137 S. Ct. at 983.

¹² *See, e.g.*, U.S. Trustee Obj. at 8.

that A&P was obtaining relief usually reserved for chapter 11 plans, such as exculpation provisions and the creation of a wind-down company, which it argued should not be available absent the satisfaction of the procedural safeguards embedded in the confirmation requirements of section 1129 of the Bankruptcy Code.¹³ McKesson's objection emphasized, among other things, that there was no clear statutory basis for such relief in the context of a structured dismissal.¹⁴

The bankruptcy court overruled the objections and entered A&P's structured dismissal order. The bankruptcy court found that the provisions governing the wind-down of the estates' remaining assets did not constitute "plan relief" nor an end-run around the Bankruptcy Code's creditor protections.¹⁵ Rather, the bankruptcy court viewed such provisions as ones that were generally available to all debtors in chapter 11.¹⁶ The bankruptcy court also found that exculpation was proper and rejected the notion that it could only be allowed through a confirmed chapter 11 plan. The bankruptcy court found that exculpation was a permissible form of protection available for court-supervised fiduciaries and court-supervised and approved transactions.¹⁷ The court explained that "[i]n the absence of gross negligence or intentional wrongdoing, parties should not be liable for doing things that the Court authorized them to do."¹⁸ The bankruptcy court observed that the lead debtor's chapter 11 case would remain open, permitting the continuation of the automatic stay for the duration of the wind-down of the estates, and that this feature of the order did not evidence an "end run" around plan confirmation.¹⁹ The bankruptcy court similarly rejected any notion that A&P's changes to its management were improper or warranted denying dismissal. It found that chapter 11 debtors often change the nature of their employment and managerial structure during chapter 11, and that doing so was especially prudent for A&P given that it had sold substantially all of its businesses.²⁰ The bankruptcy court said it would be "simply irresponsible" to contend that such actions somehow contravened the Bankruptcy Code.²¹

II Mulino's Structured Dismissal

The II Mulino debtors, a chain of luxury dining restaurants, also obtained structured dismissal of their cases following the sale of substantially all of their assets.²² Left with insufficient resources to fund a plan, and with no further operations, the debtors sought entry of a dismissal order that, among other things: (a) created a two-step procedure for first, administering claims and second, closing and dismissing cases on negative notice; (b) authorized the payment of administrative claims and allowed professional fees in accordance with the Bankruptcy Code's priority scheme; and (c) provided that all prior orders of the bankruptcy court entered in the debtors' chapter 11 cases remained in full force and effect and survived dismissal, including a sale order that exculpated key participants in the chapter 11 cases.²³ The U.S. Trustee objected, arguing that the proposed sequenced dismissal procedures were premature and dismissal should not be authorized until the cases were fully administered. The U.S. Trustee also argued that the proposed distribution scheme should not be approved by the court because it complied with the Bankruptcy Code's statutory requirements, and thus, no court approval was needed.

¹³ *Id.*

¹⁴ McKesson Obj. ¶¶ 23-34.

¹⁵ *See, e.g.*, Hr. Tr. at 43, 54.

¹⁶ *Id.*

¹⁷ *Id.* at 58. Judge Drain limited the scope of the exculpation provisions accordingly.

¹⁸ *Id.* (citing *In re Aegean Marine Petroleum Network, Inc.*, 599 B.R. 717 (Bankr. S.D.N.Y. 2019)).

¹⁹ *Id.* at 43.

²⁰ *Id.* at 90.

²¹ *Id.*

²² *In re KG Winddown, LLC*, Case No. 20-11723 (MG) [ECF No. 494].

²³ *Id.* at 5-6.

After concluding that *Jevic* did not close the door on structured dismissals, the bankruptcy court overruled the U.S. Trustee’s objections. It observed that the debtors’ other alternatives for emerging from chapter 11 would do nothing more than further erode the value of their already administratively insolvent estates with no apparent benefit to any creditors.²⁴ The bankruptcy court found no concrete reason why a two-step dismissal process should not be approved, and similarly rejected the U.S. Trustee’s argument that the court cannot (or should not) approve a distribution scheme simply because it complied with the Bankruptcy Code’s priority provisions. The bankruptcy court held that while such approval was perhaps not required, it would “precisely” serve the purpose of structured dismissals by providing certainty to the debtors and their creditors, as well as promoting the orderly winding up of the estates.²⁵

Conclusion

The approval of A&P’s and Il Mulino’s structured dismissals confirms that at least in some jurisdictions, structured dismissals remain viable alternatives to a liquidating chapter 11 plan or converting to chapter 7. The rulings provide useful guidance for debtors considering this option: (a) structured dismissals fare best if they distribute value in accordance with the Bankruptcy Code’s absolute priority rule; (b) the dismissal orders may contain exculpation provisions if limited to court-supervised fiduciaries and court-supervised and approved transactions; and (c) dismissal orders may contain other forms of relief that are generally available to chapter 11 debtors (*e.g.*, continuation of the automatic stay, wind-down trusts, claim distribution procedures, and the continued effectiveness of prior court orders).

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²⁴ *Id.* at 10.

²⁵ *Id.* at 11.

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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