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Advanced Ch. Eleven Bankr. Prac. s 10.3

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Advanced Chapter 11 Bankruptcy Practice

Thomas J. Salerno, Craig D. Hansen, G. Christopher Meyer, Jacob Schuster and George Basharis

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Current through the 2015 Cumulative Supplement

Chapter 10: Plan of Reorganization

Types of Chapter 11 Plans

§ 10.3 Plan of Liquidation

Under the old Act, corporate debtors either successfully reorganized or their reorganization proceedings were converted to straight bankruptcy proceedings, in which a trustee took control of the debtor's assets and liquidated them for the benefit of its creditors. There were no provisions that allowed the debtor to retain control of its assets and liquidate them over time for the benefit of its creditors.<sup>1</sup> Liquidating plans are permitted under the Code. 11 U.S.C. § 1123(b)(4). *See, e.g., Toibb v. Radloff*, 501 U.S. 157, 111 S. Ct. 2197, 115 L. Ed. 2d 145 (1991) (Chapter 11's structure and legislative history indicate that it was intended primarily for use of debtors with ongoing businesses; nevertheless, Code contains no ongoing business requirement for Chapter 11 reorganization.); *In re All American of Ashburn, Inc.*, 11 B.C.D. 1149 (N.D. Ga. 1984); *In re Jartran, Inc.*, 886 F.2d 859 (7th Cir. 1984); *In re PC Liquidation Corp.*, 383 B.R. 856, 866 (Bankr. E.D.N.Y. 2008) (citing cases recognizing that Chapter 11 permits liquidation in certain cases); *Loop Corp. v. U.S. Trustee*, 379 F.3d 511, 517 (8th Cir. 2004) (noting that liquidation under Chapter 11 is permitted by most courts); *In re PPI Enterprises (U.S.), Inc.*, 228 B.R. 339, 345 (Bankr. D. Del. 1998), *aff'd*, 324 F.3d 197 (3d Cir. 2003) (rejecting creditor's implicit argument that Chapter 11 petitions should be limited to reorganization situations, noting that Bankruptcy Code does not even use the term "reorganization"). *But see In re Lyons Transportation Lines, Inc.*, 123 B.R. 526, 534 (Bankr. W.D. Pa. 1991) (No authority in Bankruptcy Code allows debtor to file Chapter 11 case for purpose of self-liquidation.).

Generally, the preparation and planning involved in drafting a plan of liquidation is far less complicated than that involved in drafting a plan of reorganization. Primary consideration normally will be given to the method and timing of liquidation to maximize asset value. *But see In re Ionosphere Clubs, Inc.*, 184 B.R. 648, 653 (S.D.N.Y. 1995) (disclosure statement requirements do not apply to a pre-plan sale of debtor's assets, including sale of all of assets); *In re WBQ Partnership*, 189 B.R. 97, 102 (Bankr. E.D. Va. 1995) (sale of all of assets authorized prior to filing disclosure statement if there exists good business reason for sale); *In re Equity Management Systems*, 149 B.R. 120, 124 (Bankr. S.D. Iowa 1993). Other factors to consider include accelerated guarantor or partner liability and possible adverse tax consequences that might result from liquidation. See discussion in §§ 10.31 and 10.32 and **Chapter 13**. For example, stretching out tax payments as provided in § 1129(a)(9)(C) may not be a realistic alternative in a plan of liquidation. In addition, the debtor may need to comply with Section 1113 with respect to any collective bargaining agreements, as some courts find the section applicable in the liquidating Chapter 11 context. *See,*

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e.g., *In re Chicago Construction Specialties, Inc.*, 2014 Bankr. LEXIS 2119 (Bankr. N.D. Ill. May 8, 2014) (reviewing split among courts regarding application of Section 1113 in Chapter 7 and Chapter 11 liquidations and holding that Section 1113 applied in a Chapter 11 liquidation). See also discussion in § 7.85.

Since most of the technical requirements of § 1129 will usually be met with respect to most liquidating plans, considerations other than maximizing asset values usually are secondary. Some troubling issues do arise, however. Moreover, a liquidating or sale plan may enable both a debtor and a creditor to eliminate potentially large transfer taxes. Specifically, under [Bankruptcy Code § 1146\(c\)](#), a stamp tax may not be imposed on an instrument transferring an interest in real property if the instrument was made in connection with a confirmed bankruptcy plan. See, e.g., *Florida Dep't of Revenue v. Piccadilly Cafeterias, Inc.*, 554 U.S. 33, 52, 128 S. Ct. 2326, 2339 (2008) (holding that the stamp-tax exemption in [Section 1146\(a\)](#) of the [Bankruptcy Code](#) only applies to transfers made pursuant to a plan that has been confirmed); *In re T.H. Orlando Ltd.*, 391 F.3d 1287, 1291 (11th Cir. 2004) (transfer “under a plan” refers to transfer authorized by confirmed Chapter 11 plan; in turn, plan authorizes any transfer that is necessary to its consummation); *In re NVR, Ltd. Partnership*, 189 F.3d 442, 458 (4th Cir. 1999) (noting that tax exemptions of 11 U.S.C. § 1146(c) apply only to transfers that occur after plan is confirmed); *In re New 118th, Inc.*, 398 B.R. 791, 798-99 (Bankr. S.D.N.Y. 2009) (holding that stamp-tax exemption applies to pre-confirmation sales that close after confirmation). *City of New York v. Jacoby-Bender, Inc. (In re Jacoby-Bender, Inc.)*, 758 F.2d 840 (2d Cir. 1985); *In re Lopez Development, Inc.*, 154 B.R. 607 (Bankr. S.D. Fla. 1993) (transfers exempt from documentary stamp tax despite subsequent dismissal of case). Cf. *995 Fifth Avenue Associates, Ltd. Partnership v. New York State Department of Taxation & Finance (In re 995 Fifth Avenue Associates, Ltd. Partnership)*, 963 F.2d 503 (2d Cir. 1992) (Transfer of real property pursuant to plan does not prevent imposition of state gains tax on transfer of realty.).

However, liquidating plans under Chapter 11 are subject to several of the limitations of Chapter 7. For example, the liquidating plan cannot provide a discharge if the debtor would not have received a Chapter 7 discharge. See [11 U.S.C. § 1141\(d\)\(3\)](#), as discussed in **Chapter 12**. Unlike Chapter 11 reorganization plans, the liquidating plan cannot order the IRS to allocate the payments on its claim by requiring the IRS to treat the money as trust fund payments. See, e.g., *In re Kare Kemical, Inc.*, 935 F.2d 243 (11th Cir. 1991); *In re Laminating, Inc.*, 148 B.R. 259 (Bankr. S.D. Tex. 1992); *In re Visiting Nurse Ass'n*, 128 B.R. 835 (Bankr. M.D. Fla. 1991). *Contra Internal Revenue Service v. Deer Park, Inc. (In re Deer Park, Inc.)*, 136 B.R. 815 (Bankr. 9th Cir. 1992) (Although a liquidating plan, it was permissible to allocate payments to IRS, thereby absolving officers from personal liability.).

As an alternative to a plan of liquidation, some courts will permit the debtor or Chapter 11 trustee to request the approval of distribution mechanisms for any sale proceeds and other administrative provisions in an order dismissing the Chapter 11 case under Section 346. These cases often are referred to as “structured dismissals.” Structured dismissal orders have included claims procedures, third-party releases, and retention of the court’s jurisdiction over post-dismissal matters. See, e.g., Norman L. Pernick and G. David Dean, *Structured Chapter 11 Dismissals: A Viable and Growing Alternative After Asset Sales*, 29 AM. BANKR. INST. J. 1, 56 (June 2010). Not all courts use structured dismissal orders and such orders do raise concerns. See, e.g., Nan Roberts Eitel et al., *Structured Dismissals, or Cases Dismissed Outside of Code’s Structure?*, 30 AM. BANKR. INST. J. 20, 20 (March 2011). See also *In re Strategic Labor, Inc.*, 467 B.R. 11, 17-18, 25-26 (Bankr. D. Mass. 2012) (denying debtor’s motion for structured dismissal order and, ultimately, converting the case to one under Chapter 7).

Footnotes

- 1 . By requiring appointment of a trustee to oversee liquidation, this system added an additional layer of administrative expenses (the fees of the Chapter VII trustee and those of this counsel and other professionals), which were paid ahead of general unsecured creditors of the estate. Asset value erosion sometimes occurred when management familiar with the debtor’s business and industry was replaced with a trustee with no prior experience in the area. In addition, Chapter VII trustees often sold the assets at fire sale prices, thus losing asset value that might have been realized had the assets been sold over a longer period of time. These drawbacks

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were corrected by the 1978 Bankruptcy Reform Act, which permits a Chapter 11 debtor to retain control of its assets while liquidating its assets through a plan of liquidation.

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