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Finding the Exit: Navigating Administratively Insolvent Ch. 11 Cases



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Debtors are more frequently filing chapter 11 cases with significant secured indebtedness, few unencumbered assets and insufficient liquidity to even satisfy administrative claims. Pursuant to § 503(b) of the Bankruptcy Code, administrative claims are “the actual, necessary costs and expenses of preserving the estate.” Examples include trade claims arising from post-petition sales of goods and/or provisions of services to debtors, post-petition rent, employee claims, taxes, and professional fees. Administrative claims rank below secured claims and above lower-priority claims (e.g., general unsecured claims) in the Code’s claims-priority waterfall.

A debtor that is unable to fully pay administrative claims is considered “administratively insolvent.” A debtor’s administrative insolvency has historically been the death knell for its chapter 11 case because according to § 1129(a)(9)(A) of the Bankruptcy Code, unless an administrative claimant “has agreed to a different treatment of such claim ... on the effective date of the plan, the holder of such claim will receive on account of such claim cash equal to the allowed amount of such claim.” Accordingly, administratively insolvent debtors are frequently moved to convert their cases to chapter 7 or dismiss their cases.

Administrative creditors have extended post-petition credit to a debtor based on the reasonable expectation that they could block confirmation of a chapter 11 plan that did not fully pay administrative creditors on the plan’s effective date, consistent with § 1129(a)(9)(A). However, that expectation was dashed in the *Toys “R” Us* chapter 11 case, which became administratively insolvent after a disastrous holiday sales season and yielded only an approximately 22 percent recovery to administrative claimants.¹

With the increase in administratively insolvent chapter 11 cases, debtors are more frequently proposing chapter 11 plans that push the boundaries of the exception to the full-payment requirement for administrative claims in § 1129(a)(9)(A). These plans also explore what it means for administrative claimants to have “agreed to a different treatment of” their claims that justifies payment of less than the full amount of their administrative claims that is otherwise required under § 1129(a)(9)(A).

Over the last several months, the U.S. Bankruptcy Court for the Southern District of Texas has confirmed chapter 11 plans in *Steward Health Care System LLC*² and *Party City Holdco Inc.*,³ which allow for the respective plans to become effective based on consent programs geared toward inducing administrative claimants to accept less than full payment of their administrative claims. Similarly, the debtors in *New Rite Aid LLC*,⁴ pending in the U.S. Bankruptcy Court for the District of New Jersey, are seeking confirmation of a chapter 11 plan that only provides for a 5 percent recovery to administrative claimants.

Steward Health Care

Steward Health Care System LLC and its affiliates (collectively, the “Steward debtors”) filed their chapter 11 petitions on May 6, 2024. On July 11, 2025, the Steward debtors filed a joint liquidation plan (the “Steward plan”).⁵ The bankruptcy court approved the Steward plan on July 25, 2025.⁶ Pursuant to the Steward plan, all of the Steward

¹ *In re Toys “R” Us Inc.*, Case No. 17-34665 (KLP) (Bankr. E.D. Va.), D.I. 4083; Toys “R” Us, Adv. Pro. No. 20-03038, D.I. 146.

² *In re Steward Health Care Sys. LLC*, Case No. 24-90213 (CML) (Bankr. S.D. Tex.).

³ *In re Party City Holdco Inc.*, Case No. 24-90621 (ARP) (Bankr. S.D. Tex.).

⁴ *In re New Rite Aid LLC*, Case No. 25-14861 (MBK) (Bankr. D.N.J.).

⁵ *Steward Health*, D.I. 5492.

debtors' assets, as well as causes of action held against third parties, were transferred to a litigation trust immediately following confirmation of the Steward plan.

The litigation trust is administering the assets and pursuing litigation against third parties. The causes of action arise from outstanding accounts receivable in the amount of approximately \$349 million; claims totaling approximately \$589 million arising from the Steward debtors' insurers' alleged bad faith for failing to provide property damage and business-interruption coverage; preference claims of approximately \$390 million; damage claims of approximately \$1 billion against a medical insurance company based on alleged anticompetitive conduct; and a claim to recover approximately \$55 million in certain Medicare funds.⁷

The Steward debtors acknowledged that they lacked sufficient funds to fully pay administrative claims when the Steward plan had been approved. The Steward plan has two unique features to reduce the amount payable to the administrative claimants and give the litigation trust enough time to recover sufficient sums to satisfy § 1129(a)(9)(A)'s requirements regarding administrative claims.

First, the Steward plan established a "consent program" that was designed to induce administrative claimants to voluntarily agree to accept payments totaling 50 percent of the allowed amount of their administrative claims in full settlement of these claims. Second, the Steward plan's effective date has been delayed until June 2027 to allow the litigation trust time to recover sufficient funds to make the 50 percent settlement payments to participating administrative claimants, plus the full amount of nonparticipating administrative claims, to satisfy § 1129(a)(9)(A). If the litigation trust is unsuccessful in recovering sufficient funds, the Steward plan will not become effective, and the bankruptcy court will convert the case to chapter 7.

The Steward debtors estimated that allowed administrative claims will total approximately \$101 million without the consent program, which is contingent on at least 75 percent of administrative claims, calculated by allowed claim amount, agreeing to participate in the consent program. Successful implementation of the consent program would reduce administrative claims to \$58 million. Under the consent program and the order approving it, all holders of administrative claims arising after Nov. 15, 2024,⁸ are required to complete and file a proof-of-administrative-claim form within 20 days from the date the bankruptcy court entered the order confirming the Steward plan.⁹ Administrative claimants also received a consent program opt-out form that required holders to return the completed form by July 2, 2025, only if they chose to opt out of the consent program.

Holders of allowed administrative claims that participated in the consent program should have received payment of their *pro rata* share of a \$12.5 million fund within 45 days following entry of the order confirming the Steward

plan.¹⁰ The claims of participating administrative claimants would then be satisfied when they receive cash (including the initial distribution) in an amount equal to 50 percent of the allowed amount of their administrative claims. The additional cash required to pay participating administrative claimholders the 50 percent recovery amount would be paid on the effective date of the Steward plan.

Administrative claimants that did not timely and affirmatively opt out of the consent program were deemed to have agreed to participate in the program, accepting a 50 percent payment of their administrative claim in full settlement of their administrative claim and thereby satisfying § 1129(a)(9)(A)'s exception to the full-payment requirement for administrative claims. Administrative claimants timely opting out of the consent program are entitled to full payment of their administrative claims, as required by § 1129(a)(9)(A). Courts have held that this opt-out mechanism is sufficient to prove administrative claimant consent to accepting less than full recovery of their administrative claims, including the U.S. Bankruptcy Court for the Eastern District of Virginia in the chapter 11 cases of *Toys "R" Us*¹¹ and *Pier 1 Imports Inc.*¹² The U.S. Trustee,¹³ the Commonwealth of Massachusetts¹⁴ and creditor TRACO International Group S. De R.L.¹⁵ each appealed the confirmation of the Steward plan, and those appeals remain pending.

Delaying the plan's effective date to allow the liquidating trust additional time to pursue claims against third parties occurred in the chapter 11 case of *Sears Holdings Corp.*,¹⁶ filed in the U.S. Bankruptcy Court for the Southern District of New York. In *Sears*, the bankruptcy court confirmed the debtors' plan on Oct. 15, 2019, but the plan did not become effective until Oct. 29, 2022.¹⁷

During the more than three years between plan confirmation and effectiveness, the estate prosecuted an adversary proceeding against the debtors' controlling shareholder and other parties, seeking more than \$2 billion in damages. Administrative claimants that did not opt out of the *Sears* administrative-claims program were deemed to have consented to a 30 percent reduction of their claims and received an initial distribution of 30 percent of their reduced claim amount.¹⁸ Ultimately, the litigation recoveries were insufficient to fully satisfy administrative claims, and *Sears*'s administrative claimants only received approximately 29 percent of their claims.

Party City

On Dec. 21, 2024, Party City Holdco Inc. and certain of its subsidiaries (collectively, the "Party City debtors") filed their chapter 11 petitions. On July 11, 2025, the Party City debtors filed a joint chapter 11 liquidation plan (the "Party

6 *Id.* at D.I. 90213.

7 *Id.* at D.I. 5774.

8 Administrative claims arising before Nov. 15, 2024, were subject to an earlier administrative claims bar date.

9 The Steward debtors retain the right to object to any disputed administrative claim. Administrative claimants can participate in the consent program upon the allowance of their administrative claims.

10 *Steward Health*, D.I. 3217.

11 *In re Toys "R" Us Inc.*, Case No. 17-34665 (KLP) (Bankr. E.D. Va.).

12 *In re Pier 1 Imports Inc.*, Case No. 20-30805 (KRH) (Bankr. E.D. Va.).

13 *Steward Health*, D.I. 5854.

14 *Id.* at D.I. 5852.

15 *Id.* at D.I. 5458.

16 *In re Sears Holdings Corp.*, Case No. 18-23538 (SHL) (Bankr. S.D.N.Y.).

17 *Id.* at D.I. 10693.

18 See also *In re S. Foods Grps. LLC a/k/a Dean Foods Co.*, Case No. 19-36313 (DRJ) (Bankr. S.D. Tex.), D.I. 2724, requiring administrative claimants who opted into a consent program to agree to a 20 percent discount on their claims.

City plan”).¹⁹ The bankruptcy court entered an order confirming the Party City plan on Aug. 27, 2025.²⁰

Throughout the chapter 11 case, the Party City debtors were administratively insolvent, with insufficient assets to even fully pay the secured claims of the second-lien note-holders. Administrative claims in the case were estimated to be \$21 million. Similar to *Steward*, the Party City plan provided for the establishment of a liquidating trust to hold substantially all of the Party City debtors’ assets. The liquidating trust is responsible for, *inter alia*, pursuing causes of action against third parties on behalf of the Party City debtors’ estate, filing claim objections and resolving disputed claims, and making distributions to holders of allowed claims.

The Party City plan was premised on administrative creditors agreeing to accept a more than 67 percent discount in full satisfaction of their claims. Distributions to administrative claimants were only made possible through a global settlement agreement among the Party City debtors, the holders of the second-lien notes, an *ad hoc* committee of administrative claimants and the unsecured creditors’ committee.

Under the settlement agreement, holders of administrative and priority claims will receive distributions in the range of 22.8-33.2 percent of the allowed amount of their claims, general unsecured creditors will recover 0.1 percent of their claims, and holders of second-lien notes will recover between 0.7-2.6 percent of their claims. If the case were converted to chapter 7, second-lien noteholders would recover 1.2 percent of their claims, and there would be no recovery to holders of administrative claims, priority claims and general unsecured claims.

Also similar to *Steward*, administrative claimants were deemed to have consented to receive less than full payment of their administrative claims for purposes of § 1129(a)(9)(A), unless they completed and timely submitted an opt-out form pursuant to administrative-claims procedures established by the bankruptcy court. The effectiveness of the Party City plan was contingent on less than \$1 million in administrative and other priority claims opting out of the proposed treatment.

The bankruptcy court confirmed the Party City plan over the U.S. Trustee’s objections.²¹ The U.S. Trustee argued that requiring administrative claimants to affirmatively opt out of the proposed compromised treatment of their claims was an improper way to secure “consent” pursuant to § 1129(a)(9)(A), because creditor consent cannot be implied; rather, consent must be affirmatively provided by each administrative claimant.²²

Consistent with *Steward*, the bankruptcy court held that the opt-out procedures contained in the Party City plan were sufficient to prove consent by nonparticipating claimants and satisfy § 1129(a)(9)(A)’s exception to full payment to administrative claimants. The bankruptcy court noted that

consent was supported by certain administrative claimants having exercised their opt-out rights.

The *Party City* court also concluded that plan confirmation was appropriate because administrative and other priority creditors would receive more than they would in a chapter 7 case, and no administrative claimant objected to the settlement agreement embodied in the Party City plan. The U.S. Trustee did not appeal the entry of the confirmation order. The Party City plan went into effect on Sept. 22, 2025.

New Rite Aid

New Rite Aid LLC and its subsidiaries (collectively, the “Rite Aid debtors”) filed their chapter 11 petitions on May 5, 2025, less than a year after the company emerged from its 2023 chapter 11 case. On Sept. 3, 2025, the Rite Aid debtors filed a joint chapter 11 reorganization plan (the “Rite Aid plan”),²³ which is premised on an agreement reached among (1) the Rite Aid debtors, (2) McKesson Corp. (the Rite Aid debtors’ largest pharmaceutical supplier), (3) the debtor-in-possession (DIP) lender and (4) the pre-petition secured lender. Pursuant to this agreement, up to \$5 million of cash collateral encumbered by the DIP lenders’ liens will be used to satisfy approximately \$100 million in administrative claims.

Similar to both *Steward* and *Party City*, the Rite Aid plan is premised on administrative creditors participating in a consent program through which administrative claimants agree to accept less than full payment of their allowed administrative claims. Pursuant to the Rite Aid plan, administrative claimants would receive a 5 percent recovery on the effective date of the plan in full satisfaction of their allowed claims.

The bankruptcy court established procedures through which administrative claimants had to timely file a proof of administrative claim or else such claim would be disallowed. Under the procedures, at the time of filing their proofs of claim, administrative claimants also had to elect whether to opt out of the consent program. Administrative claimants who fail to timely complete and return an opt-out form are deemed to have agreed to participate in the consent program, but will only receive their *pro rata* distribution of the remainder of the \$5 million fund after an initial distribution is made to administrative claimants that affirmatively opted into the consent program.

Pursuant to the settlement agreement, the Rite Aid debtors and DIP lenders retain the discretion to deem administrative-claimant participation in the consent program insufficient and seek conversion to chapter 7 or dismissal of the chapter 11, instead of pursuing plan confirmation. After passage of the deadline for submission of opt-out forms by administrative creditors, the Rite Aid debtors advised the bankruptcy court that they would file a notice on the docket by late September 2025 announcing whether their undisclosed threshold administrative claim target for participating in the consent program had been achieved, or whether they will instead seek to dismiss the chapter 11 case. However, the Rite Aid debtors subsequently filed a notice with the

¹⁹ *Party City*, D.I. 1672.

²⁰ *Id.*

²¹ *Id.* at D.I. 1797.

²² Courts are split on whether an opt-out mechanism for securing the consent of administrative claimants to accept less than payment in full is proper. Compare *In re Teligent Inc.*, 282 B.R. 765 (Bankr. S.D.N.Y. 2002) (finding that consent can be implied), with *In re MolyCorp*, 562 B.R. 67 (Bankr. D. Del. 2017) (requiring affirmative consent).

²³ *New Rite Aid*, D.I. 2286.

bankruptcy court indefinitely adjourning the date by which such notice will be filed, leaving administrative claimants in limbo as to whether they will receive any distribution on account of their claims.

Similar to *Party City*, the Rite Aid debtors forecast that administrative claimants would not receive any recovery if the case is converted to chapter 7. The Rite Aid debtors will likely argue that the administrative creditors who did not opt out of the proposed treatment of their claims under the plan are deemed to have consented to such treatment pursuant to § 1129(a)(9)(A), and that confirmation of the plan is in the best interests of administrative creditors because they will receive more than in a chapter 7 liquidation.

Conclusion

It is unlikely that the number of administratively insolvent chapter 11 cases will abate in the foreseeable future, so debtors will likely continue to propose plans that provide for less than full payment of administrative claims. Accordingly, creditors should be aware of these risks when deciding whether to extend post-petition credit to a debtor. Creditors also will need to evaluate the benefits and rewards of participating in an administrative-claim program. While such participation might result in a significant discount in the recovery of their administrative claims, failure to participate could lead to no recovery on their claims. **abi**

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