Primer on Bankruptcy for Business Owners

In today's marketplace, it isn't uncommon for businesses to find themselves facing fiscal difficulties, or saddled with seemingly overwhelming debt obligations. Financial troubles can come in all shapes and sizes. Maybe the company has recently lost several large accounts. Maybe the company has been surviving by tapping into lines-of-credit or charging up company credit cards, and has not been able to generate enough revenue every month to pay current obligations much less past due debts. Maybe the company agreed to enter into an expensive real estate lease when the economy was booming, but now that things have slowed, the landlord refuses to renegotiate the lease. Maybe the company's board recently learned that the chief financial officer has not been paying the company's payroll taxes correctly, and the IRS is threatening to shut the company's doors. Believe it or not, in this economic environment your company is not alone—situations like these are increasingly common for many businesses in all types of industries.

These types of financial issues—and others like them—understandably tend to stir up a great deal of anxiety among a company's directors and officers, and raise several pressing questions for the company's board of directors and senior management team. Depending on the extent of the company's debt problems, the company may face impatient and even angry creditors clamoring for payment, or unforgiving IRS agents threatening to shut the business down. Severe financial stress distracts senior management from the day-to-day management of the company and may cause valuable employees to look for opportunities elsewhere. How can the board and senior management team know whether or not bankruptcy is the right solution to solve the company's financial problems?

What Types of Bankruptcy Are Available to Your Company

When many people think about the word "bankruptcy," they envision a situation where a business has taken on too much debt, the company's bank accounts have little or no cash, and the business's remaining assets must be completely liquidated to pay off the company's creditors. This is one type of bankruptcy, and it is regulated by Chapter 7 of the Bankruptcy Code. Chapter 7 may be the solution if the owners want to shut down the business without the expense of a formal corporate dissolution.

In a Chapter 7 case, as soon as the case is filed, a trustee is appointed by the Office of the United States Trustee ("U.S. Trustee") from a panel of trustees maintained by that office. The Chapter 7 Trustee reviews the bankruptcy schedules, and probably requests the company's tax returns, financial statements and bank records for the year or two prior to the bankruptcy filing. The Trustee's job is to determine whether there are any assets available to liquidate to pay creditors, and the Trustee herself. Trustee's are paid a nominal amount for each Chapter 7 case filed, but then get a percentage of what's brought into the estate to be distributed to creditors. About 30 days after the case is filed, the Trustee conducts a "Meeting of Creditors." This is an administrative hearing to which creditors are invited, though it is seldom that any attend. At that time, the Trustee asks the debtor's representative (normally the CEO or CFO) about the papers filed with the Bankruptcy Court, the debtor's business, and what led to the company to file the case. If the Trustee thinks there may be assets, the Trustee will also ask about those. Finally, there are times when a Trustee can recover monies paid to creditors shortly before a Chapter 7 filing, especially payments made to the company's officers or their relatives. The Trustee will want to know if any such payments were made within 90 days or one

year prior to the bankruptcy filing. If the Trustee doesn't believe there are any assets, she will file a "No Asset" report on the conclusion of the meeting of creditors. The Chapter 7 case will likely be closed shortly after that.

The above description is what happens in a Chapter 7 case filed by an entity (*e.g.* corporation, LLC, etc.) rather than by an individual. If the business is operated as a sole proprietorship, then additional considerations must be made before a case is filed, because all of the owner's personal property is potentially an asset of the bankruptcy estate and subject to administration by the Trustee.

Chapter 7 bankruptcy is not the only form of bankruptcy available to companies. Chapter 11 of the Bankruptcy Code actually provides a company with legal tools to reorganize the company's debt without liquidating all of its assets. By providing a company with time to prepare and present a reorganization plan to creditors for their approval, Chapter 11 enables a company to continue operating while reorganizing its financial affairs. The additional time and financial restructuring reduces the amount of day-to-day stress the management team is under, and allows the company to develop a plan to become financially sound again. Management can focus on current and future operations of the business, rather than looking back and worrying about how the company is going to deal with overwhelming and unrealistic debt obligations.

Cases under Chapter 11 can range from a small business reorganization to a huge multi-national company reorganization. There are some provisions of Chapter 11 which apply only to small businesses, but by and large the same bankruptcy rules apply to all types and sizes of companies. Under Chapter 11, the debtor remains in control of its business operations, unless the Court finds that management is not capable of running the business in accordance with

Chapter 11's requirements, in which case the court may appoint a Chapter 11 Trustee. After the case is filed, it is monitored by the U.S. Trustee's office. A case administrator and an attorney are generally assigned to monitor Chapter 11 cases. A meeting of creditors is also scheduled about 30 days after the case is filed. The Debtor's representative and attorney meet with the U.S. Trustee's office before the meeting of creditors for an "initial debtor interview" to see just how much thought the debtor has given to reorganizing the company and to assess how much monitoring the U.S. Trustee's office thinks it will need to do in a particular case. Much of the same questioning goes on at both the initial debtor interview and the meeting of creditors, but creditors are not at the initial interview. The U.S. Trustee will also want to review the business financials, tax returns, bank statements and other documents relevant to the debtor's business operations. The U.S. Trustee wants to make sure the debtor maintains appropriate insurance, including worker's compensation, liability and any other form of insurance which may be necessary to protect the debtor's business. The debtor, which becomes a separate entity upon filing a Chapter 11 petition (known as a "Debtor-in-Possession"), must also open new bank accounts showing "Debtor in Possession" on the account.

After the meeting of creditors, a Chapter 11 debtor continues to operate its business in the ordinary course while trying to come up with a plan to repay creditors. The court usually schedules a status conference several months after the case is filed, at which time it sets a deadline to file the Plan and a Disclosure Statement. The latter is a more detailed description showing how the debtor will be able to accomplish its Plan. The Plan confirmation process can take a considerable amount of time in even a modest size reorganization (i.e., upwards of one

year). With intelligent planning by the board of directors and senior management a company's reorganization plan should be able to be confirmed by the requisite number of creditors and eventually approved by the Court. Once the plan is approved and the debtor demonstrates it is capable of actually complying with the plan, the debtor can emerge from supervision by the Bankruptcy Court, and the company's board of directors and officers can resume operating the company without supervision by the court. A successful reorganization allows the company to put much of its past business failings behind it, other than the payments that must be made under to the Plan, and start fresh.

The rules that govern both Chapter 7 and Chapter 11 bankruptcies are found in United States Code at Title 11. Sections 701-784 are included in Chapter 7, and section 1101-1174 are included in Chapter 11.[1]

Which form of bankruptcy is preferable for your company? It depends on the circumstances and the goals of the company's board. Chapter 11, which allows for debt reorganization and continued operations, is obviously attractive to those companies that wish to keep their businesses up and running. Chapter 11 may also be a good way for a company to give it "one last go" before dissolving the company and liquidating its assets to pay off the creditors. However, in some situations, it might actually make more sense for the company to shut down the current business, liquidate all the assets, wipe the slate clean, and make a fresh start with a new idea and a new company. In those cases, Chapter 7 bankruptcy would be the preferable course of action to pursue.

[1] Another form of bankruptcy not discussed in this primer is Chapter 13 bankruptcy. Chapter 13 is similar to Chapter 11, but it permits individuals—rather than businesses—to reorganize their personal debt. This form of bankruptcy is governed by United States Code at Title 11, sections 1301-1308 and 1321-1330.

It is important to keep in mind that bankruptcy needn't signify failure, quitting, or "giving up." Bankruptcy can mark the beginning of a new and even more exciting enterprise than the existing business. For many entrepreneurs as well as established companies, bankruptcy is viewed as a strategic business decision that allows the company to jettison unwanted contractual obligations and a crushing debt load to change the course of the enterprise. It can provide the reorganized company a stepping stone to new business opportunities and potentially enormous success.

How Our Bankruptcy and Restructuring Group Can Help You

The statutes which govern the nation's bankruptcy system are federal laws that are extremely complex and challenging to understand. The entire process is driven by specific rules codified in the statute and interpreted through hundreds of reported cases from the nation's bankruptcy courts. Successfully navigating the bankruptcy process requires a thorough understanding of the Code, careful adherence to the rules, and close attention to the detailed nuances of the case law. In addition to the federal Bankruptcy Code, various state law provisions, like the California Code of Civil Procedure, further complicate the process by which a company can reduce or eliminate overwhelming financial debts. Unfortunately, it is nearly impossible for a person who is not a bankruptcy lawyer to develop a thorough, thoughtful and ultimately successful strategy for using the Code, and various provisions of state law, to solve the company's debt problems. It is critical, therefore, that the company hire an experienced

bankruptcy attorney to help the board of directors and senior management navigate the key federal and state statutes and cases that apply to your company's specific situation.[2]

The Bankruptcy and Restructuring Group at Finkel Law Group understands the applicable bankruptcy laws and has the experience your company can benefit from when considering whether bankruptcy is the best option to solve the company's financial woes.

In addition to understanding the complexities of the law, our attorneys understand what your company is going through. It can be difficult for the directors and officers to impartially assess which form of bankruptcy is better suited to their company's specific situation and objectives. Having worked with dozens of companies under some level of financial stress, our attorneys have developed invaluable insights into the real world impacts of the various forms of bankruptcy. We can offer you unbiased advice, based on similar cases our attorneys have handled, and recommend the most appropriate course of action for your company.

Finally, a good attorney can provide your company's board and senior management team with invaluable support and assistance during a very stressful period. From calling and dealing with your creditors, to renegotiating new payment arrangements, to arranging for the liquidation and distribution of the company's assets, to advocating on your company's behalf in any adversarial proceeding launched by creditors in a bankruptcy action, our attorneys can serve as both a forceful advocate and a strategic business thinker.

What to Bring When We Meet

When we initially meet with you and your management team, it is important to bring the following business documents to ensure a productive meeting:

---

[2] In fact, if your business is a corporation, LLC, or partnership, California law *requires* you to hire an attorney. Such businesses are prohibited from representing themselves.

- Any of the business's financial statements for the past year, including balance sheets, and profit and loss statements on a monthly and annual basis.

- A list of the company's major creditors so we can quickly get an idea of the nature of the company's debts, and ensure there are no conflicts of interest.

- Contracts and loans the company has entered into with any large creditors so that we can review the existing terms of credit extended to the company.

At our initial meeting, we will discuss the company's situation and start thinking about which course of action can most effectively and efficiently accomplish the company's objectives. The initial meeting is an opportunity for the company to discuss its story, clarify its objectives, and ask any questions to identify any concerns it might have with the bankruptcy process. We will answer any of your company's questions, and if appropriate, take the first steps necessary to ensure a successful bankruptcy process.

If you have not yet done so, contact Finkel Law Group today and set up an initial appointment to meet with us. You can reach us at info@finkellawgroup.com or (925) 274-9600. Whether it's time to reorganize your business's debt, or time to wipe the slate clean and make a fresh start, Finkel Law Group is ready to help you.