

Business Bankruptcies

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Different Kinds of Business Bankruptcies

There are several bankruptcy options for the entrepreneur. The correct option depends on the need or the goal. It depends on what the owner is trying to accomplish. If he wants to close his business and avoid being sued, then he may take one of several courses. If he wants to preserve his business, he has several other choices.

So, there are two main categories for business bankruptcies: ending the business or saving it. There is bankruptcy terminology for these two categories. The bankruptcy term for ending a business is known as “liquidation,” and the bankruptcy term for saving the business is known “reorganization.”

Business Liquidation

Liquidation means either dismantling the business and selling it piece by piece or selling it as a whole. So a bankruptcy liquidation can be an excellent way to end a business. Liquidation is sudden death for a business and sudden relief for the owner who has carried it for too long. Instantly the business belongs to a Chapter 7 trustee who undertakes responsibility for it.

Generally speaking, however, this type of liquidation is inevitable only when the business itself

files the bankruptcy, not necessarily when the owner of the business files his own bankruptcy.



When a corporation or partnership files a Chapter 7, liquidation occurs. And immediately upon filing the bankruptcy, all of the assets and all the control of the corporation or partnership pass to a bankruptcy trustee. A bank-

ruptcy trustee is someone who takes the business and sells it either as a whole or sells its various assets and then divides up the proceeds among the creditors of the business according to their various entitlements. Filing the Chapter 7 immediately ends the business.

But there are other reasons to place corporations into bankruptcy besides a decision to end it. For instance, as soon as a corporation is placed in bankruptcy, no lawsuits can be filed against it and all current lawsuits must cease. So, all attorney fees cease and, for the lawsuits that have not been filed, they may never be filed. And this may be very significant. Because if the lawsuits are not filed, then the owner will never be named as a codefendant in a lawsuit against the corporation. Although this does not mean that the owner will not be sued individual-

ly, it does mean that to the extent that he is a secondary party - that is, if he is a defendant who would be sued just because his corporation was sued - he will escape the inevitable lawsuits. So, if the owner will be sued just because he is the owner (some lawyers sue everyone in sight) then he can escape the lawsuits by filing a bankruptcy for his corporation. It is of course true that a Chapter 7 for his corporation will not relieve him of any personal responsibility, but many lawsuits name the principal of a business as a matter of course when they sue the corporation. The corporate or partnership Chapter 7 has a "settling down" effect on the business. However, the advisability of this practice often depends on the type of debt, who the creditors are, the kind of business and the history of the owner's dealings with his corporation.

The reason why a Chapter 7 has such a settling effect is that because it interposes a representative from the Department of Justice (a bankruptcy trustee) to oversee all of the assets, it places sworn accountings of all of the assets of the corporation and the corporation's history in the file, so the creditors (who previously may have believed there were assets to be seized) can see that further efforts are a waste of time and money. And if there are any unencumbered assets, they will be soon be divided up among the creditors without the necessity of lawsuits. Not only can creditors no longer sue, but all they have to do now to have the effect of a judgment against the corporation is to file a claim with the bankruptcy court.

The "settling down" effect of a Chapter 7 filing is often enough reason of its own to file. But there may be another purpose for a business liquidation, and that is in order to begin a new business.

Ending a business and going right back in an beginning another one may appear at first glance to be inappropriate. But it is not in the least inappropriate. Because a country like the United States that protects the right to succeed must also protect the right to fail. If it should outlaw the right to fail and and inhibit the legal right to start anew, then it would severely limit the right to succeed. Why? Because

entrepreneurs will not easily invest their capital into a business or sign their name on promissory notes if they know that if they fail, then they will not be able to begin again. The right to fail and to begin with a fresh start again is the flip side of the right to invest and succeed. One cannot have one without the other. All great men carry with them a history of successes and failures and this is what makes them great. It is not their success that makes them great, it is their overcoming that makes them great. This concept is vital to a successful bankruptcy - especially a Chapter 7.

Quite often, the true value of a small business lies in the person of the owner. The value of the owner to the business is both personal and intangible. It may find its source in the education of the owner (perhaps a doctor or a lawyer) or in the experience of the debtor or in his reputation, but wherever it comes from it is intangible and it cannot be sold by a bankruptcy estate. It passes through the bankruptcy. To some extent, it is always there and ready to be nurtured and expanded after the Chapter 7 has faded into the past.

So, the owner of a business will often file a bankruptcy himself (individually) in order to shed the weight of his guarantees and co-signings, and then, after the bankruptcy has begun, re-incorporate and start his business again. Making this work can be difficult especially with respect to the transfer of assets from the old business to the new. These transfers, if any, must be made properly and in full view of all, or the owner may implicate himself in a bankruptcy crime. But when carefully done, the liquidation of a business is often the most efficient way to reorganize.

In most cases of this nature, the owner has invested as much as any creditor in his business and has been working for a number of months with a grossly insufficient salary (or none at all) in order to save it. The business may fail because of a falling market, a well funded competitor, a tragedy, or perhaps a dishonest employee. But it is rarely because of dishonesty on the part of the owner. The owner should understand that he is just as much a creditor

of his corporation as are his lenders - and often more so.

The owner of a fallen business often has incurred much more debt for the purpose of the business than for his personal needs. In such a case where the non-consumer debt exceeds the consumer debt, the business owner may be exempt from the means test. It is the means test that is the core of the new bankruptcy law; it prevents many consumers from starting afresh. But it does not apply where the bulk of the debt was incurred for business or non-consumer purposes.

Business Reorganization

There are two reorganization type bankruptcies: Chapter 7 and Chapter 13. Each of these arise from the same basic concept, and that concept is a payback plan approved by the Bankruptcy Court that everyone has to live with. The two main differences between a reorganization plan and restructuring outside of bankruptcy is that in a bankruptcy reorganization 1) all of the creditors are required to abide by its terms and 2) most of the time less than all of the debt is paid back. A reorganization bankruptcy is therefore the means by which everyone is forced to face the reality of fluctuating markets and over-extension of credit - and to make the best of it. How does it happen? The reorganization bankruptcy revolves around a plan of reorganization. A plan of reorganization is a written proposal as to how the debtor will pay back the most that he can and still keep his business.

As soon as the debtor files a reorganization bankruptcy, all collection efforts and all lawsuits must cease and the debtor must ask the bankruptcy court to approve a plan. The plan must provide for payments to the creditors that comply with the Bankruptcy Code.

In a Chapter 11 bankruptcy, the creditors have an opportunity to vote on the plan, but in a Chapter 13 they do not have an opportunity to vote on the plan. If enough creditors vote for the Chapter 11 plan and if it complies with the statute, then the

bankruptcy judge will approve it. On the other hand, if an insufficient number vote for the plan, it is still possible that the bankruptcy judge will approve it, but it is more difficult.

In a Chapter 13 bankruptcy all the debtor needs to do is to show that he has complied with the law and the bankruptcy judge will approve the plan. So, Chapter 13 is a much more powerful bankruptcy for a debtor. But Chapter 13 bankruptcies are limited to individuals, whereas Chapter 11 bankruptcies are open to business entities such as corporations and partnerships as well as to individuals.

Chapter 11 bankruptcies are much more flexible than Chapter 13's but for that reason are less effective. Where possible, a Chapter 13 bankruptcy filed for a sole proprietor can be extremely powerful. For instance, the amount of the payback for a retail store may be limited to the auction value of the inventory, and the payments can include amounts due to IRS, the used retail value of the vehicles and the back mortgage payments. The creditors cannot vote on the plan, the debtor pays back only what he can and the bankruptcy court must approve it if the debtor complies with the statute.

On the other hand, Chapter 11 bankruptcies are made for businesses and they are designed to bring all parties to the negotiating table by means of the threat of a bankruptcy judge approving a plan that pays back only a portion of what is due whether the creditors like it or not.

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