

## **CHAPTER 11 BUSINESS BANKRUPTCY - A NUTS AND BOLTS** **LOOK AT THE REORGANIZATION PROCESS**

Corporations, LLC's and partnerships that have a viable business but are buried under a mountain of debt can file for federal bankruptcy protection under Chapter 11. This should only be done after careful analysis by business managers, attorneys and accountants who take a team approach to try to save the business. The decision to file is only made if all agree that a reorganization will help the business regain or retain market share and be able to emerge stronger after the process is completed. The cost of filing and being in a Chapter 11 case is a significant factor to consider when determining whether to file. This will be discussed in some detail below. However, in those instances where the reorganization is successful, the trade creditors stand a chance of recovering a larger percentage of their outlay rather than closing the business down and usually recovering nothing. The successful reorganization is a win-win situation for the business and creditors and communities in which they operate as the business keeps jobs in the community, vendors get paid, and taxes are still being paid to municipalities and states.

In 2012 fiscal year ending September 30<sup>th</sup>, 10,597 Chapter 11 business cases were filed throughout the United States, down from 11,979 for the same period in 2011. That is a drop of 12% over a one year period and a significant drop from the highs in 2009 and 2010 when the business Chapter 11 filings reached 14,745 (2009) and 14,191 (2010). However, it is disturbing to note that the Chapter 11 business filings have nearly doubled in 5 years since only 5,888 Chapter 11 cases were filed in 2007. <sup>1</sup>

During the same period in 2012, consumer bankruptcy filings totaled 1,219,132; down from a high of 1,538,033 during fiscal 2010. So business Chapter 11 filings represent a small portion of the total number of cases filed each year. Yet, other than celebrity filings, business bankruptcies are the ones that usually make the news. And, on a local level, business bankruptcy filings impact our lives and those of our friends and neighbors at a significant level.

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<sup>1</sup> Administrative Office of the United States Courts bankruptcy filing statistics report as of November 07, 2012

It is important to understand the process of a Chapter 11 filing and the steps a business must go through to reorganize its debts and come out the other side.

Chapter 11 business bankruptcy involves reorganizing a company's debts. In order to gain the protection of the federal court, the business must make a list of all of its debts as well as a list of all of its assets, provide accounting information including tax returns, and be open about its activities and report all of its meaningful transactions going back several years. This information is compiled into a bankruptcy petition and schedules and filed with the federal bankruptcy court along with a filing fee of \$1,213.00 to begin the case and notify all creditors of the proceeding.

The business is then considered a new and separate entity called "Debtor-in-Possession". This means that the Chapter 11 business operates with the oversight of the United States Trustee system but continues on with its business dealings in the ordinary course, on a day-to-day basis, subject to strict monthly reporting requirements to keep the creditors and other interested parties informed of the progress the business is making in refinancing its debt, forming new relationships with vendors, streamlining its staffing requirements, etc.

During this process lawsuits and collection activities against the business must cease so that it has time to concentrate on its reorganization efforts.

An important safeguard for vendors and others dealing with a "Debtor-in-Possession" is that the business must put the bankruptcy case number and the words "Debtor-in-Possession" on all of its checks. It is advisable in the business world to instruct your employees seeking new suppliers to ask the question of whether the new vendor is currently in Chapter 11. It also makes sense to have your Accounts Receivable department regularly look at checks that come into your office from current customers to see if the bankruptcy designation appears.

The debtor-in-possession is required to file a Reorganization Disclosure Statement and Plan within six months to a year from the date of filing the case. These lengthy documents and summaries are circulated to all creditors and interested parties and must discuss the history of the business, include financial projections, and generally tell the creditors how it plans to repay its various classes of debts. These classes usually include secured creditors like banks; any payroll or

sales taxes on the state and federal level; employee benefits; and unsecured trade creditors. The repayment period and actions required to make the plan work are all contained in the documents circulated. A ballot is then used by the various classes of creditors to vote on the plan. This process is often lengthy with intense discussion among the classes of creditors who all vie for the best return. The unsecured creditors in some cases get help from a Creditors Committee made up from the list of unsecured creditors who help obtain the best plan terms for their members. When sufficient numbers and classes of creditors approve the plan, it then goes to the court for approval. The judge listens to the debtor-in-possession and its attorneys and accountants and often spends a few days listening to the pros and cons of a plan before determining to approve or disapprove the implementation of the offered plan.

Once the reorganization plan is approved by the court, the debtor-in-possession must abide by the terms and implement the plan including the payment schedule set out. Often an outside accounting firm is hired to make the payments on the schedule set out in the plan. This implementation process is still under the supervision of the court and the debtor-in-possession continues to pay fees on a quarterly basis for the privilege of being under the protection of Chapter 11. These fees can be quite high depending on the amount of funds that are paid out each quarter by a business. The sliding scale of fees includes even the money spent by the business for payroll—all disbursements that go through the business. The average quarterly fee for a medium sized business is \$4,875.00, or \$19,500 per year which will continue to be paid until the plan is substantially completed—perhaps 7-10 years.<sup>2</sup>

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<sup>2</sup> Chapter 11 Quarterly Fees for 2012 - 2013

<u>Quarterly Disbursements</u>	<u>Fee</u>
\$0 - \$14,999.99	\$325.00
\$15,000 - \$74,999.99	\$650.00
\$75,000 - \$149,999.99	\$975.00
\$150,000 - \$224,999.99	\$1,625.00
\$225,000 - \$299,999.99	\$1,950.00
\$300,000 - \$999,999.99	\$4,875.00
\$1,000,000 - \$1,999,999.99	\$6,500.00
\$2,000,000 - \$2,999,999.99	\$9,750.00
\$3,000,000 - \$4,999,999.99	\$10,400.00
\$5,000,000 - \$14,999,999.99	\$13,000.00
\$15,000,000 - \$29,999,999.99	\$20,000.00
>30,000,000 or more	\$30,000.00

If a debtor-in-possession fails to adhere to the plan, a creditor or the supervisory United States Trustee office can ask the court to convert the business to a Chapter 7 which would close the doors and sell the assets of the business. On rare occasions the court might appoint a Trustee to operate the business for a period of time in the Chapter 11. This is usually done if a buyer is on the horizon, or the business must be kept operating to finish a manufacturing order which would give more value to the creditors.

If the business succeeds with its reorganization plan, then its old debts get wiped off and it can receive its fresh start while maintaining value for the remaining shareholders, members or partners.

If you are notified of a Chapter 11 filing, see if the amount of the debt listed by the business matches your records. If it doesn't, be prepared to talk with your attorney and prepare and file with the court a proof-of-claim form which will substantiate your claim to be included in a reorganization plan.

A Chapter 11 bankruptcy for businesses is a very complicated affair, both for the debtor and for all of those dealing with the debtor, whether before or after the filing of a case. There are many traps for the unwary and it is advisable to seek help from experienced lawyers who are designated ABC board-certified bankruptcy specialists to guide you through the process.