DOWN BUT NOT OUT

If your business is in trouble, Chapter 11 of the Bankruptcy Code may be the answer.
by Rudd McGary and Ed Wandtke

Because of our economy's rapid growth and the room for more business, many new companies have popped up in the green industry. This sudden influx of competitors has caused some successful companies to experience financial trouble for the first time.

Most businesses in financial trouble have alternatives: they can do nothing and hope for the best; they can attempt an out-of-court debt workout; or they can file a bankruptcy petition in court. Filing bankruptcy is necessary only if business owners can't see their business worsening and, therefore, take no corrective action.

Generally, businesses facing extreme financial difficulties should pursue one of the following:

• closing up the company and going out of business;
• selling the company;
• merging with another company; or
• restructuring the company inside or outside of a bankruptcy proceeding.

Since a crisis atmosphere usually exists under such circumstances, it is important that the owner use key personnel inside the company. He or she must also supplement that team with outside personnel, such as industry consultants and financial help from experienced legal and accounting firms.

Using the bankruptcy law to assist you in turning around your company may be the best solution for your company, but it is expensive. What are your options prior to bankruptcy? When a business person realizes that the company is in financial trouble, the following pieces of information must be determined as accurately as possible:

• total amount and age of accounts payable;
• total amount and age of accounts receivable;
• current financial statements (month and year-to-date);
• total amount of revenue that will be received between now and the end of the business year;
• evaluation of the use of personnel;
• determination of the need for all of the assets currently owned or being financed;
• weekly cash flow needed to keep the company viable; and
• listing of potential customers and the amount of business that might be obtained.

Armed with the above information, company owners need to determine the chances for a turnaround of their company. If the prospects look bleak, you may seek help from the courts under the federal bankruptcy law in order to save your company.

Bankruptcy law options
The most common action under the bankruptcy law is to have a company go out of business. This is known as liquidation, which is done under Chapter 7 of the Bankruptcy Code.

However, another section of the Bankruptcy Code, Chapter 11, allows a business to restructure its finances so that it may continue to operate, pay its creditors, provide employment and eventually provide a return to its shareholders.

The most famous Chapter 11 of the 1980s is that of Chrysler Corporation, when using various forms of credit from both the private sector and the federal government rescued the company.

Chapter 11
This is a Bankruptcy Code action done in a Federal Court and is available to C or S corporations. It is an opportunity for a debtor to freeze debts while developing a plan to repay these debts over an extended period. This process protects the going-concern value of the company. Ultimately, the program is designed to repay debts and financially rehabilitate the debtor.

Here is how a Chapter 11 works:
Filing a petition with the bankruptcy court. This information will include debtor's list of creditors, schedule of assets and liabilities and a statement of the affairs of the debtor. This action may be done voluntarily or involuntarily. If it is involuntary, three creditors holding claims aggregating $5,000 or more must allege the inability of the debtor to pay debts as they mature. If this involuntary action proves to be wrong, the courts will dismiss the action and the court may grant the debtor costs, and attorneys' fees. If a trustee was appointed and took possession of the debtor's property, the debtor may be entitled to damages.

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The effect of this filing is to immediately create an “automatic stay” to restrain all interests from continuing or commencing any action against the debtor which could have been filed prior to instituting the “automatic stay.”

Appointing a trustee. The courts may appoint a trustee or may allow the debtor to operate the business pending a further plan of workout to be prepared by the debtor. This second practice is known legally as a “debtors in possession.”

Establishing a new company. After a Chapter 11 bankruptcy petition has been filed, in essence a new corporation is formed. A new set of accounting records and new bank accounts are started. This is necessary in order to separate transactions prior to the Chapter 11 filing from those after the filing.

Appointing a creditors committee. As soon as possible after a Chapter 11 petition is filed, the Federal Court is required to appoint a Committee of Unsecured Creditors. This committee is usually composed of the seven largest unsecured creditors. The purpose of this committee is to protect the interests of the unsecured creditors and, if necessary, to petition the Federal Court to appoint a Trustee.

Additional options of the debtor. Just because a debtor has filed a petition under Chapter 11 of the bankruptcy code, he is not prevented from changing his mind and converting his petition to another chapter of the bankruptcy code. He is limited in his options if he is in an involuntary Chapter 11.

Filing the plan and disclosure statement. Any time after or at the time of filing the Chapter 11 petition, a debtor may file a plan of reorganizational. The debtor does retain the right to file the plan for up to 120 days from the filing of the voluntary petition. If an involuntary petition is filed, the debtor has 120 days to file the plan from the entry of an Order for Relief.

An Order for Relief is entered in an involuntary case only if the debtor does not respond to the involuntary petition, creditors can prove that the debtor is not paying his debts or a receiver has been appointed by the courts. An additional 60 days is given.

the court to approve a plan. Thus it will take the court up to 180 days to confirm a plan for petitioners.

Contents of a reorganization plan. The seven elements of a plan of reorganization are known as mandatory provisions. They are:

- Plan must designate classes of claims and classes of interest. In addition it requires that it must provide equal treatment for similar interests.
- Plan must specify any class of claims that are not impaired under it. Impaired means that the rights of a creditor after the plan are less than before the plan was filed.
- Plan must provide the same treatment for each claim or interest in a particular class, unless the holder agrees to a less favorable treatment.
- Plan must provide adequate means for its execution. The plan must have sufficient income to pay the debts as proposed in it.
- Plan requires that a debtor or a related corporation may issue equity securities as consideration for the claims of certain creditors. It may not issue non-voting stock to the creditors.
- Plan can contain only provisions consistent with the interest of creditors, equity security holders and public policy. This is also known as the “catch-all” provision of the law.

Accepting the Plan of Reorganization. The law provides that every class of claims or interests is either impaired or unimpaired in a Plan of Reorganization. Depending on the status of a specific creditor (impaired or unimpaired), they have the right to accept or reject the Plan of Reorganization.

Chapter 11 allows a business to restructure its finances so that it may continue to operate, pay its creditors, provide employment and eventually provide a return to its shareholders.

Confirmation and hearing. After the disclosure statement is approved, the Clerk of the Court mails out notices to all creditors and equity security holders advising them of the plan, a ballot to vote and a disclosure statement. In order to have a Plan of Reorganization confirmed, 11 separate standards need to be met by the plan:

1. Comply with all applicable sections of the Chapter 11 Bankruptcy code.
2. Proponent must comply with the disclosure provisions of Chapter 11.
3. Plan must be proposed in good faith and cannot be used to defraud creditors.
4. Plan must disclose any promise to pay or payment to be made by the proponent.
5. The court will have the right to know and confirm all officers of the debtor company and any affiliated companies.
6. All regulated companies continue to be bound under those regulations for rate approval.
7. Court must determine that each class and each holder of a claim will receive the value of his claim upon liquidation of the plan.
8. Each class of claims or interests must accept or not be impaired under the plan.
9. Priority claims must be paid in full unless the claim holder consents to a different payment plan.
10. One class of claims must accept the plan without any acceptance by an insider.
11. Confirmation of the plan will not be followed by a subsequent liquidation of the company under a different Bankruptcy Code action.

Post-Confirmation Matters. Once a Plan of Reorganization has been confirmed, all of the property of the estate vests in the debtor unless otherwise provided for in the plan. Any claim not filed in the court prior to the confirmation hearing is likewise discharged once the Plan of Reorganization is accepted. Any debt that cannot be discharged via a Chapter 7 Bankruptcy likewise cannot be discharged in a Chapter 11 action.

Summary When a business starts to find itself in financial trouble, it is important to get the full picture before undertaking corrective action. Only by knowing the severity of the financial condition can an advisor provide the guidance needed to choose a course of action. Most businesses can be saved if corrective actions are undertaken. Only after all avenues of relief are exhausted should the company be placed in either Chapter 11 or 7. LM

Disclosure Statement—creditor advice. A Disclosure Statement is similar to a stock prospectus except that it does not go into the depth of information disclosure. Each class of creditor is provided the necessary information about the Plan of Reorganization which will enable them to vote on the plan.

Approval of the Disclosure Statement is obtained by an affirmative vote of two-thirds of each class of creditors who choose to vote.