

## **ALTERNATIVES TO CHAPTER 11 REORGANIZATION**

By Attorney Steven Weiss, Shatz, Schwartz and Fentin

If your business is in financial trouble, it may be tempting to consider filing a Chapter 11 bankruptcy petition. There may be many potential benefits: it puts at least a temporary stop to creditor collection efforts, it provides a venue in which to reduce a company's debts, and it may create the vehicle from which to emerge from bankruptcy as a leaner, stronger company. However, Chapter 11 is no automatic panacea for an ailing business.

Chapter 11 proceedings are expensive and a considerable distraction to the regular conduct of business. There will be supervision and reporting requirements with an unsecured creditors committee and the United States Trustee. The fees for the company's bankruptcy attorneys and other professionals are considerable. There will almost certainly be reductions in revenue immediately after customers learn of a Chapter 11 filing. And while it is relatively easy to get into Chapter 11, successfully emerging from bankruptcy is by no means assured. Fortunately, there are simpler, less costly alternatives; indeed, the best reorganizations are usually the ones that never see the inside of the bankruptcy court.

Perhaps the most important part of the reorganization analysis is to take a cold, dispassionate look at a business to see if there is really a "core" business that can be successful. This can be particularly difficult for owners of small businesses, who may have spent their adult lives developing the operation, or for owners who have taken over operations from the family founders of the business. However, there is little point to incurring the financial—and emotional—efforts of reorganization if there is little chance of success. So business owners need to ask some tough questions. Are the financial troubles attributable to a "one time" event, such as the loss of a major customer? Or are they due to a steady decline in revenue? Are certain parts of the business dragging down the other, more

profitable lines? Are there weaknesses with current management that can be resolved? Is the amount of debt that won't go away easily, e.g., bank debt and tax obligations, too high to be addressed even in a reorganization? As it is (obviously) difficult for a business owner to give these questions a truly unbiased analysis, it is useful, and probably imperative, to involve legal and financial advisors in the process.

If there is a viable business plan, the next step is to determine whether the plan can be accomplished without a Chapter 11 reorganization, and the first part of this process is to determine the primary sources of the financial pressure. For instance, if a secured lender is threatening collection action, then management's efforts should be focused on reaching some accommodation with the lender. Secured lenders obviously have to be concerned with customers' performance; however, except in rare instances, lenders would rather have a client continue to operate and make payments than have to liquidate their collateral. Thus, banks may be willing to enter into forbearance agreements. Typically, these agreements provide for reduced payments and time to restructure a business or seek alternate financing. Lenders may also be willing to allow borrowers to liquidate unnecessary assets or business lines on a "going concern" basis, which will usually generate better results than an auction sale.

If, on the other hand, the primary business is suffering pressure from trade creditors, there are other tactics. Fortunately for small businesses, unsecured creditors have limited legal remedies and little leverage in collection efforts, especially if the bank lender has a "blanket" lien on all of the business assets. And most sophisticated creditors know this. So trade creditors are often willing to take a significant discount on their claims simply because getting something is better than nothing. These discounts can be affected in a number of ways, depending on the circumstances of each business. In some instances arrangements can be made with individual creditors. If the creditor pressure is broadly based, making individual settlements may not be practical. Surprisingly,

a carefully worded letter from counsel, explaining the circumstances, and proposing either a moratorium on debt payments or discounted settlements to all trade creditors, may be accepted by the overwhelming majority. In some circumstances, particularly in larger businesses in which there are concentrated creditor bodies groups of creditors may combine to form an informal committee to negotiate a settlement with creditors.

Many, indeed, maybe most, Chapter 11's being filed in recent years are not "true" reorganizations; instead, they result in sales of the company's business as a going concern. Again, while there may be reasons to sell a business through the bankruptcy process, there are non-bankruptcy alternatives to a court-supervised sale. Chief among these are assignments for the benefit of creditors. These are non-judicial business liquidations conducted under Massachusetts law. Management can choose the assignee, usually an attorney with bankruptcy and collection expertise. The assignee conducts his or her due diligence, to ensure that the sale transaction is a fair disposition of the assets, and that there will be at least some meaningful dividend to unsecured creditors. The assignee has wide latitude in how the sale will take place; while it can be by auction, he or she can also sell the assets as a going concern, which may contain terms favorable to management, such as employment agreements. Once the assets are sold, the assignee notifies all creditors and provides them with a form for submitting their claims. If sufficient numbers of creditors accept the assignment, the assignee then makes a distribution to creditors. Again, the benefit to trade creditors is that they receive partial payment on their claims far more quickly than would be the case in liquidation proceedings in bankruptcy court.

Ultimately, Chapter 11 is like any other legal strategy; it may be useful, but only in the right circumstances, and only after other, less costly alternatives are considered.

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