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WE HELP PEOPLE STRUGGLING WITH DEBT

Five Options for a Struggling Business

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OVERVIEW

If your business is experiencing financial difficulties, it is important to know what options are available to help your business (and ultimately you as the business owner(s)). Generally, there are five options available for a U.S. based business that finds itself struggling with financial difficulties:

1. Selling all or part of the business or its assets.
2. Workout agreement(s) between the business and its creditor(s).
3. Reorganization of the business under the U.S. Bankruptcy Code.
4. Liquidating the business.
5. Abandoning the business.

Each of these options is discussed in greater detail below:

SELLING YOUR BUSINESS

The first option that should always be considered for a struggling business is a sale of the business (or part of the business) or a sale of business assets. Unfortunately, this is also the most unlikely option.

Selling a financially troubled business is difficult for many reasons. Potential purchasers are rarely going to pay top dollar, or even fair value, for a business that is in trouble. The best time to sell your business is when things are going very well and that is often NOT the time when a business owner wants to sell their business.

However, if your business has substantial intangible assets that indicate that the overall value of the business potentially exceeds present debts, you might be able to sell all or part of the business. These intangible assets can include favorable business locations, a unique competitive advantage, a well known brand, a long record of success, excellent business reputation or other forms of goodwill.

Selling a part of a business or business assets can also help a struggling business. However, if the business wants to continue to operate, the business cannot sell assets that are vital to the continued operation of the business.

WORKOUT AGREEMENTS WITH BUSINESS CREDITORS

A workout agreement is an agreement between a business and its creditors that typically extends the time for the repayment of business debts and/or also reduces the amount of the debt. A workout agreement is a non-bankruptcy option that will allow the business to continue to operate.

Typically the business will have to agree to certains restrictions, limitations, changes and parameters as set out by its creditors in the agreement. It is a negotiation and the business owner will typically have to accept certain restrictions placed on it by its creditors for a workout agreement to be finalized. However, there is a lot of flexibility to the conditions that the parties can agree upon in a workout agreement.

Advantages of the workout agreement include avoiding the cost, delays and stigma associated with a bankruptcy filing for a business that wants to continue to operate. Disadvantages include getting all creditors to agree to the agreement. As there is no bankruptcy protection, a single creditor can blow up the entire deal by refusing to go along with the agreement.

REORGANIZING THE BUSINESS UNDER THE BANKRUPTCY CODE

Technically, there are three different chapters of bankruptcy available for a business to reorganize and continue to operate (Chapters 11, 12 and 13). Practically, for most businesses that want to continue to operate and reorganize through bankruptcy, Chapter 11 is the main option.

Chapter 11 will allow a business to continue to operate as a “debtor in possession.” The debtor is charged with dealing with the business property and business operations for the benefit of the business creditors and interest holders. There are very strict rules to how a business must operate while operating as a debtor in Chapter 11 bankruptcy, especially when it comes to cash or cash collateral (property easily converted to cash).

One of the main benefits to filing for Chapter 11 is that the business's creditors must immediately cease all actions against the debtor or the debtor's property. This "automatic stay" can give the business some much needed breathing room to make the necessary changes to get the business back on track. Additionally, the debtor receives a moratorium of several months on the payments of its debts.

Disadvantages to Chapter 11 include the costs and additional burdens placed on the business. Chapter 11 is very expensive and the strict requirements on the debtor are burdensome. It can be difficult to successfully handle both the bankruptcy requirements and the operations of a business that is already facing challenges.

If a business can be classified as a "small business debtor," some of the requirements of Chapter 11 are less burdensome.

Chapter 12 is a very specific type of bankruptcy reorganization only available to a "family farmer" (an individual or business whose income is primarily from farming operations).

Chapter 13 is the most common form of reorganization used by individuals but corporations are not eligible to file for Chapter 13 relief and there are also strict debt limits. It's not a practical option for a business looking to reorganize and continue to operate.

TERMINATION OF THE BUSINESS VIA LIQUIDATION OR ABANDONMENT

If the business cannot be sold, a workout agreement is not feasible and a Chapter 11 reorganization is not possible or practical, termination of the business via liquidation or abandonment is the final option.

LIQUIDATION

A liquidation is basically the bringing of a business to the end and distributing remaining assets to the business creditors and shareholders in order of priority.

If a business has significant assets that are not pledged as security for a loan, if the business

owners are personally liable for business debts, or if the ratio of debts to assets is low then the business should consider a liquidation. It is extremely important that the liquidation is done properly.

A formal liquidation of the assets of a business can be done through the Bankruptcy Code or through the state corporate dissolution laws (the preferred method). The process of properly liquidating or “winding down” a business is complicated and there are many traps for the unwary. Transfers of property of the business must be done in a very specific fashion or these transfers can be considered fraudulent or preferential. This can cause many issues down the road for the owners of the business and/or the recipients of the transfers.

A proper business liquidation will typically minimize the damage to all interested parties. Unfortunately, for most businesses the liquidation will not completely satisfy all debts and often the business owners are still personally liable for remaining debts of the liquidated business. Many creditors often require that the owners of a business “personally guarantee” the debts of the business. If a business is properly liquidated and there are still debts remaining that have been personally guaranteed by the owners, the owners may need to explore personal bankruptcy to discharge any remaining financial obligation.

The reality is that many business failures will cause a personal bankruptcy filing of the business owners.

ABANDONMENT

While simply closing the doors and walking away from a struggling business may at times sound like an appealing option, it rarely works out for the owner of the business. It’s very rare for a business owner to not have personally guaranteed any of the debts of the business. Most savvy creditors will require a personal guarantee for the debts of the business to keep the abandonment option off the table.

Please do not hesitate to reach out to me if you have questions about your struggling business. I never charge for a phone consultation. Since 2002 I’ve focused my law practice on helping individuals, families and small businesses move on from debt struggles. We help people struggling with debt.

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