

## **5 Things Every Small Business Owner Must Do Before Filing Chapter 11 Bankruptcy<sup>1</sup>**

By Jamie L. Harris, Esq.

*This is an advertisement.*

1. *Assess the Relief Needed.* When considering the need for bankruptcy relief, the first step for any small business owner is to assess the health and future of the business. Will the business have the cash flow to sustain current operations or is downsizing necessary? What corporate assets and liabilities exist? Can the business sustain operations if debts are restructured? Every small business owner must answer these questions in determining whether liquidation or reorganization is appropriate. While Chapter 7 bankruptcy typically involves the orderly liquidation of corporate assets under the supervision of a trustee who makes distributions to creditors, Chapter 11 bankruptcy involves developing a plan that restructures debt and focuses on continued business operations, although the plan of reorganization may include a partial liquidation or the sale of the business as a going concern. Liquidation pursuant to Chapter 7 or a simple wind down may be the best option when the business has no future, there are no substantial assets, or the debts are so overwhelming that restructuring is not feasible.

2. *Strategic Planning.* Small business owners need to be realistic about the benefits of reorganization. While reorganization can free up additional cash by restructuring pre-existing debts, it will not increase revenues or create a market. Chapter 11 can offer several benefits including the ability to modify pre-existing debts to extend maturity dates or lower interest rates or to reject leases or contracts that are no longer profitable. Additionally, the claims of secured creditors can be crammed down to the current value of their collateral. In developing a strategy for reorganization, business owners must assess what changes in operations, management, or debt structure will be necessary for continued operations. In order to generate sufficient revenue to fund the reorganization, business owners must consider changes in marketing and advertising, price adjustments for services or products, location changes or downsizing.

3. *Keep Accurate Financial Records.* The filing of a bankruptcy subjects a company to heightened scrutiny regarding its finances. There are additional rules and requirements placed on a “small business debtor” (as defined by the Bankruptcy Code) which are somewhat different from larger chapter 11 cases. A small business debtor is required to file, if prepared, its most recent balance sheet, statement of operations, cash flow statement, and tax return within days of filing bankruptcy. If the company’s records are scarce or inaccurate, some level of pre-bankruptcy planning may be appropriate to begin accurate record keeping and the employment of an accountant may be necessary. During the bankruptcy, the small business debtor will be required to file monthly operating reports which disclose its financial activity including income and expenditures. The Office of the United States Trustee is charged with monitoring all chapter 11 cases, and

---

<sup>1</sup> This article is a service for friends and clients of DelCotto Law Group, PLLC. The opinions expressed in this article are intended for general guidance only and not as recommendations for specific situations. As always, readers should consult a qualified attorney for specific legal guidance.

will often request additional historic information for verification of information reported in the bankruptcy filings.

4. *Develop a Budget.* After a business files chapter 11, it will often seek to use some or all of its cash flow for operations. To the extent that cash constitutes the proceeds of a creditor's collateral, it is considered "cash collateral" under the Bankruptcy Code. "Cash Collateral" may include business accounts, inventory and other collateral such as post-petition proceeds, products, offspring, rents, or profits that are subject to a properly-perfected creditor's lien. The business may not use cash collateral without the creditor's consent or the Bankruptcy Court's permission, so the business must initially assess whether it will have any unencumbered cash flow during the bankruptcy. In developing a budget, the business must make realistic income projections for several months and factor in additional expenses including the legal fees and administrative costs of the bankruptcy and additional fees for other professionals including accountants.

5. *Evaluate Personal Finances.* While Chapter 11 will protect corporate assets, many small business owners are co-debtors with the business based on the execution of a personal guaranty or potential individual tax liability. Every small business owner must consider the impact that the corporate bankruptcy will have on his or her personal finances. A personal bankruptcy may be appropriate or temporary injunctive relief may be an available remedy to the owner while the business reorganizes.

If you would like more information on small business bankruptcies, please contact Jamie Harris at [jharris@dlgfir.com](mailto:jharris@dlgfir.com).