

## **NONPROFITS AND BANKRUPTCY**<sup>1</sup>

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Nonprofit entities are eligible for bankruptcy relief; however, a nonprofit cannot be forced by creditors to file bankruptcy nor can it be forced into a Chapter 7 liquidation bankruptcy after it has filed for reorganization under Chapter 11 of the Bankruptcy Code. In the past, failing nonprofits may have closed their doors and simply dissolved pursuant to state law, but there have been a recent growing number of nonprofit organizations filing to reorganize or liquidate themselves under the Bankruptcy Code.

While nonprofits are distinguishable from regular corporations, since they have no shareholders and are organized for a charitable or public purpose, bankruptcy affords them similar benefits as other corporations. Under Chapter 11 of the Bankruptcy Code, nonprofits can obtain relief from creditors, renegotiate leases, and propose a reorganization plan that allows them to emerge from the process financially viable or, in the alternative, liquidate the nonprofit's assets. Like other corporations, a nonprofit entity will have an exclusive right to submit a plan of reorganization for the first 120 days of the bankruptcy case.

There are certain important differences that affect nonprofit entities with members. The absolute priority rule, which typically requires that each creditor holding an unsecured claim receive the full value of its claim before any interest holder holding a lower priority claim receives or retains any interest on account of its claim or interest, may not be applicable to the nonprofit if its members' interests are not analogous to shareholders, i.e., no right to share in profits or receive other benefits. This would allow the nonprofit to obtain plan confirmation over the objection of unsecured creditors.

In evaluating whether to voluntarily dissolve pursuant to state law or file for bankruptcy relief, nonprofits need to understand the benefits of Chapter 11 as well as the special considerations affecting nonprofits in bankruptcy including issues involving the absolute priority rule as noted above, the specific treatment of endowed and non-endowed funds in bankruptcy, or the process of selling a nonprofit's assets in bankruptcy.

If you would like more information regarding nonprofits and bankruptcy, please contact Jamie L. Harris at [jharris@dlgfir.com](mailto:jharris@dlgfir.com).

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