

Next chapter

Options beyond bankruptcy for struggling businesses

INTERVIEWED BY ADAM BURROUGHS

In the middle market, businesses are feeling the financial crunch. Pandemic-era governmental incentives are ending, interest rates are on the rise and consumer demand for some products is waning. These factors have led to sharp increases in bankruptcy filings. In the first six months of 2023, Chapter 11 reorganizations reportedly increased by 68 percent, with filings for small businesses climbing by 55 percent.

“Those that were relying on the easier cash, lower interest rates, or where there were struggles pre-pandemic are now being negatively impacted,” says Chris Niekamp, Akron Office Partner-in-Charge, Buckingham, Doolittle & Burroughs, LLC.

Smart Business spoke with Niekamp about bankruptcy and bankruptcy alternatives for companies with cashflow struggles.

WHAT OPTIONS EXIST FOR COMPANIES WITH SIGNIFICANT DEBT?

Bankruptcy is an extreme decision and an expensive process. Before filing for bankruptcy, companies could consider restructuring their debt, refinancing, selling the business or finding a partner.

Some companies in tough financial straits realize that they may be nearing the end of their business lifecycle and look for a solution to get out of debt and close their business. State courts often offer the best options. Secured creditors may force a debtor's hand by filing for foreclosure. A receiver is often appointed to manage the liquidation process and attempt to pay off creditors by marketing the company's assets and selling them free and clear of liens potentially at a going concern value. This process could maximize the value of those assets by selling them for higher prices than could be attained through a bankruptcy sale.

Chris Niekamp

Office Partner-in-Charge | Akron
Buckingham, Doolittle & Burroughs, LLC

330.258.6470
cniekamp@bdbl.com



WEBSITE: For more solutions to address significant debt in your business, connect with Chris at bdbl.com/attorneys/christopher-j-niekamp.

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Orderly state court-supervised liquidation or assignments for the benefit of creditors are debtor-initiated alternatives to bankruptcy. In the assignment case, assets are assigned to a designated assignee and then a state court manages the assignment and authorizes the assignee to market and sell the assets for the benefit of creditors. Through an orderly liquidation, a company can be dissolved voluntarily or through the court, and then the assets are sold through a wind up process approved by the court which could allow the business to continue to operate as part of the wind up and liquidate its assets after it's dissolved. The process can take, in some cases, several years depending upon the complexity of the business and option to sell it as turnkey.

HOW DO THESE OPTIONS COMPARE TO BANKRUPTCY?

Bankruptcy, especially Chapter 11, can be very costly. Entities that file for bankruptcy protection under Chapter 7 do not receive a discharge, which means the company is still in existence at the end of the process and there are additional costs to fully dissolve and close the entity.

However, bankruptcy can be necessary in some cases because the process includes a powerful automatic stay provision that is enforceable by a federal judge across state lines. That provision effectively shuts down all creditors from trying to grab assets and

continue litigation. A state court order, comparatively, usually only impacts the parties to the litigation and may be more difficult to enforce on out-of-state entities. Also, for businesses that can afford the professional fees — Chapter 11 Bankruptcy offers debtors an opportunity to reorganize and continue operating post-bankruptcy. A Chapter 11 case can often result in a five-year reorganization payment plan.

WHO SHOULD COMPANIES WORK WITH IF THEY'RE CONSIDERING BANKRUPTCY?

Some small businesses, desperate to fix their cashflow situation, enter into terrible lending transactions with receipt funders, who will lend money with extremely high interest rates and take an assignment of the company's accounts receivable as collateral. Many businesses ultimately cannot afford to pay back those loans and end up seeking state court dissolution or bankruptcy as a way to get out of these arrangements.

Before taking a subprime loan, talk with advisers to find better alternatives. Qualified advisers could include lawyers with experience in workouts, bankruptcy and state court options, as well as financial advisers and certified public accountants. Get professional input before making a decision that could potentially worsen matters for an already struggling business. ●