



BY ANDREW STEIL

WEIGH OPTIONS BEFORE FILING FOR BANKRUPTCY

THE LONG SUMMER DAYS HAVE PAST. The cold has come, and days have shortened. The changes to colder and darker days mirror the reality that many businesses and families continue to struggle financially, with some turning to bankruptcy protection. Bankruptcies in Minnesota during the first two quarters of 2009 were higher than the entire year during 2006. In fact, more than 10,000 people and businesses filed bankruptcy in Minnesota during the first two quarters of 2009.

Bankruptcy has a serious trickle-down impact on our local businesses. Here is a look at bankruptcy, its ramifications and when to consider filing for it.

Realities

Local businesses and community banks are hit hard when a business files for bankruptcy protection. The money owed usually will never be paid back, and the creditor has to absorb the financial loss.

For a business, there are generally two types of bankruptcies: Chapters 7 and 11. A Chapter 7 bankruptcy is known as “liquidation.” For a business, Chapter 7 is usually used to liquidate the business, pay off its secured creditors with the business assets, and after the asset sales, if money remains, pay taxes. If anything is left, then it’s used to make some pro rata payment to general unsecured creditors (mostly vendors). A Chapter 7 bankruptcy nearly always results in the business closing.

A Chapter 11 bankruptcy is known as “reorganization.” In a Chapter 11, a debtor attempts to adjust its debts and repay creditors a possibly discounted amount based upon its classification, such as secured or unsecured. During the Chapter 11 filing, a secured creditor usually attempts to negotiate the repayment of the money owed

to it. A Chapter 11 bankruptcy can be an expensive and long proposition. General unsecured creditors will likely get something but substantially less than their whole debt, if the plan is successful. Unfortunately, most Chapter 11 filings fail.

Possible reasons

While every business is unique and many times a situation spirals beyond the business’s control, there are several common themes when businesses file for bankruptcy protection.

The general reasons range, including market crashes (such as real estate), cash flow problems, weak senior management, high business expenses, customer losses and increased competition in a niche market.

Generally a business will attempt to reorganize when it needs to substantially reduce unsecured debt in order to service secured debt or pay taxes (“trust” taxes such as withholding taxes cannot be discharged in bankruptcy). Reorganization also can provide a way to negotiate a change in repayment terms of secured debt.

Results

When someone files for bankruptcy, an individual debtor’s credit will be negatively affected, and obtaining credit from lenders in the future will be more difficult and expensive. The secured creditors’ liens existing before the bankruptcy will, except in limited circumstances, continue. If the debtor is not paying secured debt, a creditor can still foreclose on real property or take back personal property collateral.

There are debts which bankruptcy cannot fix. If a person has committed fraud, such as siphoning money to secret accounts and failing to disclose it, a creditor’s attorney and/or the bankruptcy trustee will most likely sniff this out. In addition to not having the debt get wiped out, the debtor may face criminal charges. And debts that were accrued under false pretenses, such as providing false financial information in a loan application, may result in the debt not being wiped out in the bankruptcy.

Bankruptcy is a huge decision that should not be taken lightly. It should only be an option if it is discussed after careful consideration with the help of skilled counsel and your accountant. **ROI**

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