

DON'T BE AFRAID OF THE "B" WORD

Despite historic acceptance of debt cancellation, which dates to Roman times, there are still negative connotations to filing for bankruptcy under any chapter of our federal bankruptcy laws. Bankruptcy in America today, however, is not so much for deadbeats but for the businesses or individuals seeking financial restructuring, rehabilitation, extension and some elimination of debt — essentially an opportunity to start over.

Why has Congress adopted what some consider a lenient policy toward the discharge of debts? It may be the influence of an American entrepreneurial spirit that has influenced our lawmakers to reject old-fashioned remedies such as locking debtors in wooden stocks or throwing them into prison and to appreciate people who take a financial risk, lose and work to start over.

We have learned that those people are more likely to rebound and contribute to commerce than the ones who are shackled with debt they can never repay. Many successful Americans fit this category. Howard Johnson, for example, is reputed to have gone broke six times before he started over selling ice cream on

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Nantasket Beach near Boston. Similar stories exist in all sectors of American business.

A creditor will make more money by selling or loaning to new customers or even those who have been through bankruptcy than by chasing debt-ridden individuals. In essence, our laws give an entity a chance to

start over by eliminating, extending or restructuring debt. We have learned that these laws also are good for business.

Chapter 11 is one of three chapters under the bankruptcy code offering relief to financially distressed individuals or businesses. Chapter 7, available to all businesses and consumers, is referred to as a straight bankruptcy and provides for a court-appointed trustee to liquidate all nonexempt property. Chapter 7 usually results in a discharge of all debt with the exception of some taxes, some fraudulently incurred obligations and certain domestic claims. Chapter 13, frequently referred to as the Wage Earner Plan, is for individuals only, requires 36 to 60 monthly payments and has a debt limit.

Chapter 11 is the choice for virtually all business cases. It is available in all sizes, from United Airlines to the neighborhood grocery. Chapter 11 permits a restructuring, extension of debt, reorganization and even a partial or complete sale of assets. It has no debt limits and is available to all individuals and business entities. Chapter 11 can be explained best by defining in simple terms some phrases used routinely in business reorganizations.

Debtor: the individual or entity that owes money and typically files the bankruptcy petition under Chapter 7, 11 or 13.

Debtor in possession: the individual or business that files Chapter 11 and stays in control of the business without the appointment of a trustee. The debtor stays in possession if he and his counsel follow the basic court rules. The theory is that the individuals who are running the business can usually operate, liquidate or reorganize the business better than a trustee or other outsider.

Creditor: a bank, insurance company, loan company, taxing authority or any other entity that is trying to collect money from the debtor.

Automatic stay: puts an immediate stop to all suits, foreclosures and other creditor action. The practical effect is that the debtor or the business owner can apply his mental energy to productive efforts instead of fighting the collection efforts of creditors. The stay lasts until the case is concluded or until it is lifted by the court for other reasons.

Liquidation test: allows the debtor in Chapter 11 to, in a sense, pay for what he keeps. A debt may not be paid in full but only in an amount that the creditor would otherwise receive if the debtor's property were liquidated in a Chapter 7.

A sale free and clear of liens: allows the bankruptcy court to order a public or negotiated sale of property, even if there are mortgages, tax liens or judgments against the property. The purchaser gets a clear title, and the court sorts out later how the money is distributed.

Confirmed plan: the goal of the Chapter 11 debtor. The bankruptcy court enters an order confirming the plan of reorganization and describing the treatment of all debts. All creditors are bound by the order.

Chapter 11 is favored by businesses and individuals with high debt loads for several reasons. First, Congress has established a national policy that prefers the rehabilitation or reorganization of a troubled

Chapter 11 is one of the benefits of a legal philosophy that favors rehabilitation.

business with the owner in control to liquidation of assets by a trustee, a foreclosure or a forced sale of business assets.

Second, Chapter 11 enables the debtor to remain in possession and control of its assets and operations without the appointment of a trustee. Third, Chapter 11 has no debt limits and is available to all individuals and businesses. The Bankruptcy Code even has a special provision for small businesses that contemplates an expedited process for the small businesses that qualify.

Bankruptcy practitioners and those who deal with debtor-creditor issues are committed to Chapter 11 as an effective tool for financial rehabilitation and for treating all creditors in a single forum. Factors often associated with a successful reorganization include:

- A desire to stay in business and continue practices that have been successful in the past;



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- A good accounting system and a willingness to follow the rules of the bankruptcy court and the bankruptcy administrator;

- A need to downsize, sell unnecessary property or sell property that is subject to numerous liens, while keeping the assets needed to reorganize effectively;

- The existence of numerous disputed creditors that need to be addressed in one forum, without the expense of separate lawsuits; and

- A business that is subject to an industry problem, a seasonal problem or a cash flow problem that is not typical of the ordinary operation of the business.

Businesses that are not as successful in Chapter 11 often are operated by inexperienced individuals, by those who do not really want to continue in business, do not keep accurate records or who are not willing to follow the rules of the court and advice of counsel.

Like all legislation, the bankruptcy code and its related statutes are subject to abuse. For those who are willing to work within the system, however, Chapter 11 is an effective way to take advantage of a legal philosophy which favors reorganization and rehabilitation and allows the debtor to enjoy a fresh start instead of liquidation and financial failure.